INDIA'S STERLING POSITION AND THE WAR

By

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PREFACE

I need hardly make an apology for writing this treatise on the growth of the sterling balances of India during the war, and the question of their utilisation. No one who takes an interest in the problems of post-war reconstruction, be he an Indian or a Britisher, can afford to go without a knowledge of the circumstances that led to our prodigious accumulations of sterling, or fail to take note of the ways and means that may be available to us for repatriating our sterling assets in London. In fact, this entire subject has come to acquire to-day an international significance, and the problem of the transfer of our sterling balances affects not only the economy of the two countries immediately concerned in such transfer, *viz.*, India and Britain, but of the world at large. I have laid down the broad principles that underlie the question of the transfer of our sterling balances to India, and have also made in this connection a few suggestions.

I have devoted considerable space and attention to one use, already made, of our surplus sterling in London, *viz.*, that for the repatriation of our sterling loans. I have scrutinised every particular scheme of repatriation, and have tried to draw out, within the limits of the data available to me, its principal economic implications. I have attempted to arrive at valid conclusions touching both upon

the methods adopted for repatriation as also on the results obtained therefrom.

I regret some of the topics discussed in the book could not receive fuller treatment. The war has necessarily imposed various restrictions on the access to materials, and I have had to work subject to such restrictions. Particularly, Chapter VI on 'Repatriation by Empire Countries' is incomplete in many details, and it seems hardly likely that it will be possible to write a full account of the subject-matter of that Chapter until after the expiry of some time from the end of the war. In the next place, scarcity of paper has also played its part in forcing the author to make his arguments as concise as possible. As a rule, all but strictly necessary elaboration has been avoided, as also quotations.

In conclusion, I owe it to myself to say that for encouragement as well as for valuable advice in the writing of this book, I am greatly indebted to my teacher Dr. J. P. Niyogi, M.A., Ph.D., University Professor of Economics, Calcutta University. I am indebted to Mr. Prafulla Kumar Das of *The Indian Historical Quarterly* for reading the proofs.

Readers are requested to read 'two-fifths' in the place of "one-fifth" at the opening of the fifth line from the end, on page 12.

Calcutta,
August, 1944.

BIMALENDU DHAR

DEDICATED

TO THE MEMORY OF

MY NIECE

KALYANI DHAR

WHO PASSED AWAY ON

AUGUST 16, 1944

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INDIA'S STERLING POSITION AND THE WAR

CHAPTER I

THE STERLING DEBITS AND CREDITS OF INDIA

THE accumulation of a large and increasing amount of sterling to India's credit in London since the outbreak of the present hostilities has been one of the chief financial events of the war, and it has attracted much attention not only in India and Britain but elsewhere. It has also given rise to a lot of speculation regarding the proper utilisation of these ever-increasing sterling funds.

The sterling or the pound sterling is, or was, until recently, the leading currency unit of the world. A bank account in sterling in London was supposed to be a very good investment, and, as a matter of fact, a considerable volume of short-term foreign capital, to which nearly every important country of the world contributed its share, used to be always kept in the city of London. Being almost universally accepted sterling provided in fact, until the last thirties, the nearest approach to an international currency standard the world had seen. British monetary policy since the last great war as well as various international circumstances have, however, shorn the sterling in the recent past of much of its international significance, and have restricted it to a great extent to its home country. Its importance as

a universal medium of exchange had already greatly waned when the present war broke out, and just at present it is a national currency more than perhaps it ever was.

One cannot too much emphasise the fact that the sterling is not something fixed or unalterable either in terms of metallic content or purchasing power. It is, in fact as well as in law, only the name by which the British unit of account goes. It need not be made of any metal at all as, indeed, at present it is not. Public ideas and prejudices, however, die hard and many people require to be told in so many words that sterling is not today the same glittering gold once it used to be. The pound sterling has lost its golden form ever since the last great war. For a brief while after 1925 it was linked to gold, and not gold coin, but since September, 1931, when Britain went off the gold standard, the convertibility of sterling into gold bullion ceased to be a legal liability of the Bank of England, and that remains the position to this day.

Originally the pound sterling was a metallic coin. The first British pound was made of silver, and not gold, containing, as the name indicates, a pound weight of the white metal. In the Middle Ages, most European countries had silver coins of pound weight, but the weight of the pound was not the same everywhere. The English pound, being of somewhat heavier build than other pounds, came to be marked off from the rest, and was called the pound sterling or the most excellent pound.

Later on the pound sterling came to be made of gold. The first gold sovereign of twenty shillings weight was issued only in 1816. Previous to that gold guineas had been in circulation since 1663, but their value was not constant —it was twenty shillings at first and became twenty-two shillings ultimately. The gold sovereign has also had a chequered career, and its existence was thrice in danger in the nineteenth century due to severe monetary crises that swept Britain. It went out of circulation at the outbreak of the last great war, and has not put in an appearance again.

We repeat, therefore, that a sterling balance does not necessarily connote a fund of gold, or of silver, or, for that matter, of any other specified commodity. It signifies merely an amount of purchasing power available in Great Britain. It has value-in-exchange in England, and value-in-exchange, in normal circumstances, in terms of other currencies of the world. Just at the present moment, however, its value in terms of other currencies is a matter of regulation by monetary authorities in Britain and is, even at that, very much restricted in scope. It has long ceased to have an intrinsic value or value of its own. Its purchasing power, moreover, is not fixed. It may rise or it may fall. Under some circumstances it may become more valuable than gold and under some, again, less useful than waste paper.

Whatever be the status of sterling internally or in the international mart, various circumstances have given it a peculiar significance to India. We shall presently find

reasons that make it almost incumbent upon this country to keep in London large ready resources in sterling. These circumstances arise mainly from the fact that on current account India is a debtor country to Britain. India's inferiority to the latter in industrial and commercial spheres—an inferiority which, happily enough, is being now progressively overcome but which, so long as it lasts, is bound to continue to engender her substantial invisible imports; her heavy external liabilities in respect of interest and other charges—liabilities which may be traced to both economic and political grounds; and various other circumstances connected with questions of high finance and international exchange—all these have in the past contributed to India's great demand for sterling. To meet this demand, it has been necessary for her to appropriate certain sources of supply of sterling, and to build in London certain sterling funds over and above her current needs—needs that might arise in an emergency.

It is important to grasp this basic fact of India's position in relation to sterling. It is that many of her sterling obligations are related to political and monetary considerations and arise apart from imports of merchandise. On current account, as has been mentioned several times earlier, India is heavily in debt to Great Britain—or used to be so before the war—and this debt is expressed in sterling. This makes it important for the country to be in command of ready resources in sterling in London.

Theoretically, there may be nothing wrong in one country maintaining considerable overseas balances in terms of the currency of another country. Many important countries have had recourse to such a practice, e.g. Japan. A nation disposes of its total wealth in that manner which it considers to be most conducive to its own interest, and under some circumstances that interest may be best furthered by a portion of its wealth being kept in terms of the currency of another country. Such external balance may prove exceedingly useful when the foreign country concerned is a well-to-do nation, developed alike in industry and agriculture, and in whose finished products or raw materials the home country may be interested. If we recall in this connection the scramble which the British Government made, prior to her lease-lend arrangements with the U.S.A., for dollars dispersed in numerous private pockets in Britain, we shall understand better the circumstances under which one nation's interest in the currency of another may take on a vital aspect.

It behoves us therefore to approach this question of India's sterling resources in London with an open mind. Under some circumstances such foreign resources may become the cause of political friction, heart-burning and discord. Under others they may constitute a most valuable asset conferring upon the holding nation considerable material (and even political) good. Before we can be qualified to pronounce a final or even a tentative verdict upon this issue

of the sterling balances of India, it is necessary that we should have a correct understanding of India's normal requirements of sterling and her sources of supply of sterling. We shall then be able to embark profitably upon a discussion of the nature of India's war-time abnormal sterling accumulations and the question of their disposal. An objective study of India's demand for and supply of sterling, as they stood on the eve of the war, is given below. For obvious difficulties in making a correct estimate of invisible items in India's balance of accounts, the present study is confined chiefly to India's balance of transactions in merchandise, treasure, and Government remittances of funds.[1]

Reference has already been made to India's various sterling commitments in Great Britain. The most prominent among them may be briefly described. As is well known, the Government of India (and also, to a much lesser extent, some provincial governments) have, as a part of their routine functions, certain responsibilities to be fulfilled in London. We may omit the provincial governments from further reference in this connection for, in fact, their sterling liabilities do not, even in the aggregate, amount to much. But the central revenues of India are chargeable with various expenses that are to be incurred in sterling in London—expenses which, in their sum-total,

1 Such an estimate comprising both visible and invisible items has been attempted for the period 1898-1913 in Y. S. Pandit: *India's Balance of Indebtedness.*

amount to millions of pounds. Such sterling expenses we cannot ignore. Take, for example, the Secretary of State for India. He constitutes a considerable sterling liability upon this country for, although he himself is fully paid from the British exchequer, his famous India Office—comprising his advisers and other paraphernalia—is not; and it makes a large draft upon the revenues of India. The High Commissioner for India again, who lives in London, is a hundred per cent. sterling liability, speaking from the monetary point of view. Another important item in India's sterling commitments used to be, before the war, her heavy interest charge due on account of her numerous sterling loans and this constituted, in fact, the most significant single factor in India's annual sterling remittances to Britain. In recent years, this interest charge (calculated in rupees) was as follows: 1937-38, Rs. 16,60,74000; 1938-39, Rs. 16,62,43,000; 1939-40, Rs. 16.48,80,000; and 1940-41, Rs. 16,07,68.

India's obligations in London in connection with the pensions and salaries of British officials (retired and on furlough) and her obligations in connection with her sterling annuities are further factors in her demand for sterling. Sterling is also required by India to discharge her annual commitments in Britain on account of the Defence Services. Expenses incurred in this connection come mainly under the head "non-effective" and they "consist in the discharge of liabilities in connection with individuals who are no longer

in service, and are practically restricted to pensions and gratuities." They include, however, rewards for military services. The following figures illustrate India's defence expenditure in Britain in recent years: 1937-38, Rs. 8,91,02,380; 1938-39, Rs. 8,40,60,834; and 1939-40, Rs. 4,31,48,041.

The total requirements of this country with respect to sterling on these and other heads come to a considerable sum of money every year. The recurring expenses of the Government of India alone in London in sterling are known as the "Home Charges"—a term of expression not so happily worded and hence not much in use now-a-days. On the eve of the war of 1914-18, these so-called 'Home Charges" stood in the neighbourhood of twenty million pounds. Subsequently, they rose considerably and reached the high-water-mark of £34·21 millions in 1936-37. The net sterling expenses of the Government of India in recent years were as follows:—1940-41, £22·28 millions, 1941-42, £24·96 millions.

Apart from the purposes of such obligations of a recurring nature, as indicated above, various other factors are normally in operation thrusting upon the Government of India a necessity to find sterling. Thus, the Secretary of State for India and the High Commissioner for India perform certain functions in London on behalf of the Government of India (e.g. the purchase of silver by the former and of stores by the latter) for which they have to be

reimbursed in sterling. We have already mentioned that these two functionaries require sterling for their own purposes as well. In view of the fact that the remittance of sterling from the Indian end to the Secretary of State for India and the High Commissioner for India in London—whether for their own purposes or for the purpose of enabling them to perform such agency functions as stated above—has to wait upon the exigencies of the rate of exchange, whereas sterling is required by both of them—for whatever class of purpose—from day to day, it is necessary that both should have the facility of having in their possession some cash balance of sterling over and above the amount actually needed by them for scheduled purposes during a year. The necessity to furnish the Secretary of State for India and the High Commissioner for India with these working balances in sterling no doubt augments India's total demand for sterling. The following table illustrates the cash balances in sterling with the Secretary of State for India and the High Commissioner for India in the last decade.

Sterling Balance with the Secretary of State for India and the High Commissioner for India.

Year	£	Year	£	Equivalent in Rs.
1930-31	5,553,284	1936-37	581,036	
1931-32	15,864,942	1937-38	719,799	95,97,322
1932-33	9,894,992	1938-39	574,415	76,58,868
1933-34	15,656,288	1939-40	561,596	74,87,943
1934-35	15,765,479			
1935-36	569,531			

The decline since 1935-36 is due to the fact that from that year the Reserve Bank of India took over many of the fiscal functions formerly entrusted to the Secretary of State for India and the High Commissioner for India.

The introduction of the Reserve Bank of India necessitated the institution of another sterling fund in London known as the Silver Redemption Reserve. Under Section 36(1) of the Reserve Bank of India Act of 1934, the Government of India is liable to pay the Bank full legal tender value or sterling for surplus rupees returned to it by the Bank under the provisions of that Section. To enable them to meet this obligation the Silver Redemption Reserve was constituted by the Government of India with effect from 1st April 1935 with a capital of Rs. 10 crores or £7,500,000 invested in sterling securities. The assets of the reserve fell for a while, but they have been kept at a constant figure of £7,500,000 since 1937-38.

Another predominantly sterling fund, the Gold Standard Reserve has, with the constitution of the Reserve Bank of India, ceased formally to exist, though not in actual substance. It may be stated that prior to the establishment of the Reserve Bank of India, the Government of India used to undertake various fiscal functions, among which was included responsibility for maintaining the external value of the rupee. On the recommendations of the Fowler Committee appointed in 1898 a special fund called Gold Standard Reserve was called into existence, out

of the profits of rupee coinage, to enable the Government to fulfil this function. On the ground that the Government needed resources for the purpose of the Fund only in London, the bulk of the assets of the Fund, and sometimes the entire assets, used to be kept in London. When the Government of India relinquished their fiscal functions to the Reserve Bank of India in 1935, the assets of the Gold Standard Reserve (excepting a small portion) were handed over to the Bank. The assets, of course, continued to be maintained by the latter in London, for the Reserve Bank acceded to the functions for which the assets used to be held. The special designation of a Reserve was, however, abandoned. Though the Reserve Bank now keeps in London (as we shall see presently) much greater sterling funds than what constituted the Gold Standard Reserve, the following statistics regarding the corpus of the Reserve (during the quinquennium just preceding its abolition) and the manner of the allocation of the assets composing it, are of interest as indicating the amount of sterling which India needs for the purpose for which the fund used to be held—viz., the maintenance of the external value of the rupee.

Gold Standard Reserve
How the Balance was kept.

Year	£ Closing Balance on 31st March	£ Gold in India	£ Gold Held in Bank of England	£ Cash at Bank of England	£ Total estimated value of British and Colonial Government securities and Corporation of London bonds.
1930-31	39 185,887	6,247.200	2,152,334	1,085	31,599.381
1931-32	39 853,780	27,153,000	2,152,334	29	10,694,637
1932-33	39 735,713	11,626,000	2,152,334	897	26,220,766
1933-34	39 866,367	...	2,152,334	568	37,847.098
1934-35	39 472,828	...	2,152,334	2,137	37,845,529

The Reserve Bank of India is not only responsible for maintaining the external value of the rupee but it is the sole authority for the issue of paper currency. The law relating to the composition of the paper currency reserve constitutes another factor in India's demand for sterling. The Reserve Bank Act of 1934 requires that not less than one-fifth of the assets of the Bank shall consist of gold coin *or* gold bullion *or* sterling securities, subject to the condition that the value of the gold in the reserve is not less than Rs. 40 crores. Thus sterling is given the same status as gold for the purpose of the paper currency reserve of India.

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On the eve of the war when India's paper currency amounted to only Rs. 216·78 crores and the value of gold in the reserve amounted to Rs. 44·42 crores or 20·3 per cent of the whole, the apparently harmless but really very significant provision for an almost indefinite substitution of sterling securities for gold in the reserve did not provoke any attention. The role which sterling can play in the currency reserve of this country has revealed itself more and more as the war has been in progress. The war has brought about an unpecedented expansion in the paper currency of India, but the gold in the currency reserve has not increased by an ounce. With India's paper currency standing at above Rs. 900 crores at present (Rs. 917·37 crores on the 5th May, 1944) and gold in the reserve standing at only Rs. 44·4 crores, the ratio of gold to notes issued is now less than 5 per cent. This contrasts very sharply with the corresponding ratio of 20·3 per cent. on the eve of the war. Thus we find that all the tremendous increase in the paper currency of India during the war has been supported by sterling and not by gold.

Sterling has in fact an almost unlimited scope in the paper currency reserve of this country. The rules relating to the reserve, prior to the Ordinance of 8th February, 1941, provided that, subject to the condition already stated, *not less* than 2/5 of the rupee liabilities of the Bank must consist of gold or *sterling*. There was no bar, however, to the proportion being much greater as, in fact, it always

was. Rupee securities in the reserve were restricted to one-fourth or Rs. 50 crores, whichever was higher, and could be increased by Rs. 10 crores only in an emergency with the special permission of the Governor-General. It was not, however, obligatory to hold rupee securities, and if the authorities so pleased they might hold none at all. In strict law, the whole paper currency reserve, in excess of the minimum amount of gold worth Rs. 40 crores (valued at 8·47512 grains of fine gold per rupee), could consist of sterling alone. Be it said that it can so consist even now after the Ordinance. The Ordinance referred to above required the ratio of gold coin or bullion or sterling securities in the paper currency reserve to be maintained at two-fifths, but this was hardly significant, for the ratio of gold and sterling to the total reserve, thanks to the easy expansiveness of sterling, was already higher than two-fifths, and was ever becoming, with the passage of time, higher and higher still. The real significance of the Ordinance lay in the fact that it made provision for the holding of rupee securities in the reserve (either by themselves or along with silver coin or metal) to the extent of three-fifths. As a matter of fact however, rupees and rupee securities in the paper currency reserve are now much less than three-fifths, and sterling securities alone much more than two-fifths of the total. On the 5th May, 1944, total gold and sterling securities in the Issue Department of the Reserve Bank of India amounted to Rs. 844·3 crores, sterling securities amounted to Rs. 799·8

crores, rupee coins amounted to Rs. 14·8 crores and rupee securities to Rs. 58·3 crores. The total note issue amounted to Rs. 917·4 crores. These statistics gave the ratio to notes issued, of gold and sterling securities at 92·0 per cent; of sterling securities at 87·2 per cent. and of rupee coin and securities at 7·96 per cent. Thus we find that on the aforementioned date sterling securities in the paper currency reserve were higher than four-fifths, and rupee coin and securities were less than one-tenth.

Thus we find that the rules enforced in this country with regard to the composition of the currency reserve subject sterling to heavy demand from the Government of India. Rs. 800 crores of sterling for paper currency reserve makes an impressive record no doubt.

It has also to be admitted, however, that but for this free scope for sterling in the reserve, India's paper currency would have been much less elastic than it is; and the Government of India would have found it a well-nigh impossible job to finance their war effort on the scale they did. For had expansion of paper currency been conditional upon provision of gold or silver in the reserve, there could hardly have taken place much expansion; for, as every body knows, in an emergency both these commodities tend to be in extremely short supply.

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which that need arises. India, as is well known, is at present on a sterling exchange standard. The maintenance of such a standard requires that the chief currency authority of the country, viz., the Reserve Bank of India. shall bind itself to make sterling freely available to all those who need it. in exchange for rupees, at a fixed rate of exchange; and also that it shall undertake to buy sterling of all those who want to sell it, up to any extent, at a given buying rate. The Reserve Bank of India has, in other words, the same sort of obligations under the sterling exchange standard with respect to sterling as the Government of India used to have previously, in the days of the Gold Exchange standard, with respect to gold. This high obligation the Bank will fail to fulfil unless it has in London ready resources in sterling which it allows to be constantly drawn upon and replenished, according as sterling is sought to be bought from it or sold to it by mercantile or other classes, by central or provincial governments, banks or other institutions. Whether buying or selling sterling, the Bank must try to keep up its balances in London at a certain standard level, determined on grounds of feasibility and expediency,—a level below which it shall not permit its balances to fall and above which it shall not care to see them rise.

The connection between the Reserve Bank of India's open market operations in sterling, the stability of the rate of exchange, and the need for maintaining a sterling fund in London may bear a little more elucidation. Under

Clauses 40 and 41 of the Reserve Bank of India Act of 1934, the Bank is obliged to sell sterling to anybody who makes a demand in that behalf, and pays the purchase price in legal tender currency, for immediate delivery in London, at a rate not below 1s. 5 49/64d. to the rupee; it is also under an obligation, in a similar manner, to buy sterling from anybody who makes a demand in that behalf, for immediate delivery in London, at a rate not higher than 1s. 6 3/16d. to the rupee. In honouring its first obligation the Bank prevents a fall of the rupee below 1s. 5 49/64d.; and in honouring the second, the Bank prevents its rise above 1s. 6 3/16d. Thus, as a result of these two obligations together, fluctuations in the sterling value of the rupee are restricted within the narrow limits of 1s. 5 49/64d. -1s. 6 1/16d. Thus the stability of the foreign exchange, which, if not a *sine qua non* of a sound currency system, is at least an important condition thereof, cannot be maintained unless the convertibility of the home currency at fixed rates in terms of an important foreign currency (which, in the case of India, is sterling) is fully ensured through an unlimited obligation to buy and sell the foreign currency concerned being imposed upon the central banking authority of the country. A sterling fund is therefore an important prerequisite to the maintenance of the stability of the external value of the rupee; it fulfils, more or less, the role of an exchange equalisation account.

Now, as regards our sources of sterling, that which has

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been traditionally most productive is, of course, the celebrated and never-failing export surplus of the country. India has always sold more goods outside than she has imported therefrom, and thus has had always some amount of debt owing to her on current account from the rest of the world. This recurring foreign indebtedness to her on account of her transactions with other countries in merchandise and treasure has given her her main supply of sterling. Part of this sterling she has liquidated in paying Home Charges and meeting other obligations in England; a part has been utilised for purposes of currency reserve and exchange stabilisation as indicated above; and a part she always used—until recently—to purchase gold from abroad, which traditionally went into her hoards—thus justifying the epithet given to her by the foreign nations as "the sink of the precious metals."

This recurring export surplus of India has been no index of the economic prosperity of the country, but, as is now a commonplace to remark, it has been only a measure of her backwardness and external indebtedness. This paradox is explained by the fact that the export surplus of India has been always balanced, and more than balanced, by her invisible imports. For these invisible imports she has had to find sterling; and to find that sterling she has had to maintain an export surplus. Barter terms of trade deteriorate when an export surplus has to be got up on forced conditions.

The following table illustrates India's export surplus (balance of trade in merchandise only) in the present century:

Quinquennial Average	Excess of Exports over Imports (in lakhs of rupees)
1899-1900 to 1903-4	40,24
1904-05 to 1905-09	45,59
1909-10 to 1913-14	72.56
1914-15 to 1918-19	66,58
1919-20 to 1923-24	39,33
1924-25 to 1928-29	102,49
1929-30 to 1933-34	37,46
In the Year	
1934-35	20,91
1935-36	2,53
1936-37	48,33
1937-38	12,55
1938-39	14,46
1939-40	44,13

Since 1931-32, when England went off the gold standard, India has added a new source to her supply of foreign exchange or sterling, *viz.*, exports of gold. Whereas in 31 years from 1900-01 to 1930-31 India imported (net) gold coin and bullion worth Rs. 547,75,47,829,

in only 9 years between 1931-32 and 1939-40 (the latest year for which figures have been published) gold coin and bullion of a total value of Rs. 382,52,38,069—or, approximately, Rs. 42·5 crores annually was drained away from this country. These gold exports. however undesirable from other points of view, have been useful to India in the adjustment of her balance of accounts, as for various reasons her export surplus on merchandise account has in recent years tended to fall away, and, but for the heavy gold exports, it would have been extremely difficult, if not impossible. for her to maintain the external value of the rupee.

With regard to silver also, India became an exporter for the first time in the present century in 1931-32. The amount of silver exported by India between that year and 1935-36 was Rs. 14,78,18,986. This was however more than balanced in the next four years, 1936-37 to 1939-40, by imports of silver which amounted to Rs. 17,70,61,065. Silver therefore has not, on the whole, given us a supply of foreign exchange; it has rather made a call upon the country's resources of the same.

A small part of India's supply of sterling came before the war from British contribution to the defence budget of India. As a result of recommendations made by the Capitation Tribunal (known as the Garran Tribunal) India has received since 1933 an annual grant of £1½ millions from the British exchequer for her expenses incurred in training British troops in India. In view of the sharp increase that

took place in the defence expenditure of India in 1938 due largely to increase in the pay of British army officers, consequent upon similar increase in England and also increase in the equipment of naval and air forces, the British Government agreed to supplement, with effect from 1st April, 1939, the Garran Contribution of 1933 by an additional £500,000 annually.[1] Over and above this, India received a capital grant of £5 millions for the reequipment of certain British and Indian units in India.

A far more substantial British contribution to the defence budget of India has since become available as a result of the recommendations of the Chatfield Committee which was appointed by His Majesty's Government in September, 1938, on the suggestion of the Government of India, for tendering advice on the steps that might be taken with a view to the better organisation, equipment and maintenance of the forces in India in accordance with modern requirements. The Committee, which reported early in 1939, estimated the total capital expenditure involved in modernising the Indian Army at Rs. 45,77 lakhs (£34 millions), and recommended that the whole of this be provided by His Majesty's Government in the first instance—three-fourths as a free gift to India and the balance as a loan,

1 Vide The Legislative Assembly Debates September 13th, 1938, the speech of Sir James Grigg, Finance Member to the Government of India.

free of interest for five years. The Chatfield proposals—also postulating that the Government of India would accept joint responsibility with His Majesty's Government for the external defence of India, and would therefore agree to earmark certain portions of the Defence forces in India for the purpose of external defence—recommended a further increase of £500,000 in the amount of the annual grant made by His Majesty's Government towards the cost of maintaining the Defence services in India in peace time

The Chatfield recommendations were accepted by the British and the Indian Governments shortly before the outbreak of the war, and, it will be noted, they greatly increased India's supply of sterling from British official sources. The war, however, which soon broke out, made even the Chatfield recommendations out of date. It enormously increased the defence expenditures in India of British and Indian Governments and thrust upon the former far heavier responsibilities for the defence of India.

India's supply of sterling from British official sources, during the war, comes out of various factors. First, the British Government has agreed, despite the war, to go on implementing the Chatfield recommendations. Secondly, the impact of the war has made it necessary for the British Government to take upon themselves far heavier responsibilities than in peace-time for defence expenditure incurred in India. Obviously, the considerations that held good in peace-time for the allocation between the British and Indian

Governments of responsibility for the Indian defence expenditure could not claim necessary validity in every detail when a war was actually in progress. The whole question of apportionment of responsibilities between the British and Indian Governments for the total war bill of India became the subject of protracted negotiations between the two governments soon after the outbreak of hostilities, and these negotiations resulted in a Financial Settlement agreed upon by both the parties. It was decided, in terms of the Settlement,[1] that India should bear, as her own share of the war expenses, (1) a fixed annual sum representing the normal effective costs of the Army in India under peace conditions; (2) an addition to allow for rises in prices; (3) the cost of such war measures as can be regarded as purely Indian liabilities by reason of their having been undertaken by India in her own interests; and (4) a lump sum payment of Rs. 1 crore towards the extra costs of maintaining India's External Defence Troops overseas. Under this financial settlement which was brought into force retrospectively from 1st April 1939 and is to last for the duration of the war, India recovers annually from the British Government a sum of money by which her net annual defence expenditure exceeds the aggregate of items (1) to (3).

Moreover, India, rich in raw materials, is a natural base of supply of various articles of war and even Indian

1 Vide Finance Member's Budget speech for 1940-41.

industries have been geared to some extent to war production. His Majesty's Government and also various other Allied Governments find it worth while to purchase from India every year enormous quantities of war materials for which they have taken the liberty of making payment in sterling. The initial rupee finance of these purchases has been made the responsibility of the Government of India which lends its good offices in the making of these purchases within the country. Thus, the more does India supply articles of war to the Allied Governments the more does her stock of sterling accumulate in London—and, it may be added, the more does inflation accentuate at home. These war purchases of external Governments have in fact put an enormous strain upon the Indian rupee, and the Government of India, finding it impossible to secure adequate rupees by direct means (such as taxation, defence loans, etc.) have launched upon unlimited creation of rupees against unusuable sterling receipts in London.

Recoveries of sterling by the Government of India from His Majesty's Government alone on account of recoverable war expenditure (in terms of the Financial Settlement) and supply of war materials have steadily grown in volume with the progress of the war. As these recoveries have exceeded the remittances of sterling for which the Government of India are responsible so as to keep the Secretary of State for India and the High Commissioner for India in funds for various purposes for which they require sterling, the war

has reversed the time-honoured direction of flow of sterling between India and Great Britain—there being now-a-days no remittance of sterling from India to England but refund of sterling to the Government of India by the Secretary of State after necessary appropriations in England, for authorised purposes, out of total recoveries from His Majesty's Government.

Thus in 1940-41, while the requirements of the Secretary of State and the High Commissioner for India amounted to £22,855,000 (£580,000 for Burma) the receipts of the Government of India from the U.K. Government for recoverable war expenses and supplies amounted to £32,375,000. The net refund received, therefore, amounted to £9·52 millions. In the budget for 1941-42, provision was made for a net refund by the Secretary of State of £26 millions in course of the year. Owing, however, to a continuous increase in the volume of recoverable war expenditure and purchase of war materials by the U.K. Government, total payment of sterling by His Majesty's Government amounted to as high a figure as £150·75 millions. The requirements of the Secretary of State and the High Commissioner for India and Burma amounted to £24·96 millions. The net refund of sterling for 1941-42, therefore, after making provision for the requirements of the Secretary of State for India and the High Commissioner for India, and also for the repayment of the 2½ per cent. and 3 per cent. undated loans, amounted to £53 millions.

Total sterling payments by His Majesty's Government, up to the end of 1941-42 from the beginning of the war, amounted to £258 millions.

The war has thus transformed India's position *vis-a-vis* sterling. As already stated, India had to remit to Great Britain annually, prior to the war, considerable amounts of sterling—an obligation that had often serious repercussions upon the budget of the Government of India and caused headache to many a Finance Member; but now, thanks to the peculiar circumstances created by the war, England has to remit to India annually considerable sums in sterling. The annual remittance of sterling from England to India takes place, moreover, on a far more substantial scale now-a-days than did formerly sterling remittance from India to England.

Essentially, this is a situation that must be gratifying to every Indian. It shows that on current account we have now become a creditor to England—as we were never before. India's pre-war resources in sterling arising from her export surplus and other factors analysed above were hardly adequate to her requirements under all heads. The great shrinkage in her export trade since 1930-31 made India's position in her balance of accounts with the rest of the world precarious and her balance of trade in merchandise shrank so low that it was inadequate to meet even remittances of funds through official channels, let alone remittances made through private channels. The following table sets off,

since 1931-32, India's balance of trade in merchandise against balance of remittances of funds on Government account. The latter balance takes account of the following items: (a) Council bills, purchases of sterling and other Government remittances to U.K. up to 1934-35, and Purchases of sterling by the Reserve Bank of India since the year following; (b) sterling transfers on London sold in India up to 1934-35 and Sales of sterling by the Reserve Bank of India since the next year; (c) Transfers of Government securities and (4) Interest drafts on India in respect of Government of India securities.

BALANCE OF TRADE

In lakhs of rupees

Year	Balance of Trade in Merchandise (private)	Balance of Remittances of Funds (through official channels)	Net Balance
1931-32	+34,83	−34,32	+51
1932-33	+ 3,22	−48,63	−45,41
1933-34	+35,67	−60,44	−24,77
1934-35	+23,42	−49,78	−26,36
1935-36	+30,55	−46,45	−15,90
1936-37	+77,76	−71,34	+ 6,42
1937-38	+15,88	−29,90	−14,02
1938-39	+17,38	−33,00	−15,62
1939-40	+48,81	−96,88	−48,07

\+ Denotes net exports (credits) and − denotes net imports (debits).

The position has been retrieved only by heavy exports of gold.

The above discussion leads to the conclusion that, if India is not to correct her adverse balance of accounts by exports of gold, she must set herself to augment her resources of sterling. The war has given this country a great opportunity, of which she has taken full advantage, to acquire enormous quantities of sterling. On current account we are now a creditor to Great Britain as we were never before.[1]

One use of the sterling funds after the war therefore will be to stop exports of gold from India or, to speak more accurately, to prevent the resumption of the exports at the end of hostilities—gold exports on private account being now already suspended, for the duration of the war, under the Defence of India rules.

But India's resources in sterling in Great Britain have reached such an enormous magnitude (they verge at present on £1,000 millions), and increases in them continue to take place at such a fast rate that the question is naturally raised of the right way of using them in the interest of the country. Even after every allowance is made for the main-

1 No account is taken in this discussion of capital movements in sterling in respect of which India remains a debtor to Great Britain as before.

This question is discussed more fully in Chapter VII.

tenance in London of an adequate sterling fund for use after the war, in squaring, say, an occasional stringency, much too great an amount would still remain over to let us feel particularly easy about them. Indeed, the question of the disposal of the sterling balances of India after the war—it being admitted that so long as active hostilities continue not much in the way of a solution can be done about them—has already assumed an acute shape. What adds to the complication of the problem is the fact that the sums involved are so great that they cannot be moved, even after post-war restrictions are removed, without causing some serious disturbance to international economy. This has raised the very domestic question of India's disposable sterling funds in London to the plane of international discussion and deliberation, and it hardly seems likely that it will rest entirely with this country to do as she pleases with her surplus sterling in London after the war. America is already taking a hand in the matter, as also some Dominions.

There is, however, no bar to India using her sterling funds, even during the war, for such transactions within London as involve no transhipment of goods overseas or conversion of the funds into any other foreign currency. India has already helped herself in this way to a remarkable extent. She has already paid off her sterling loans, dated and undated, including railway debentures but for very small amounts which were inaccessible, and in this manner she has turned to very excellent account nearly £300

millions of her surplus sterling. She has also disposed of some further amount in other ways, e.g., making provision for her future liabilities in connection with the railway annuities.

Before we come to discuss how India ought to dispose of her huge surplus sterling that still remains over to her in London, and which tends all the while to increase, let us examine the very important steps she has taken already in the direction—steps to which a brief allusion was made in the preceding paragraph. We come, in other words, to a discussion of the repatriation of her sterling loans by India.

CHAPTER II

THE REPATRIATION OF THE STERLING LOANS

Repatriation by India of nearly the whole of her sterling debt—her only external public obligation—in the space of a few brief years after the outbreak of the war is a star event in her financial history, and may be regarded as an evidence of her economic opportunism. This achievement became possible, however, mainly because, in this important matter, the economic interest of India proved to be the counterpart of that of Britain—thus facilitating both policy and its execution. What criticism the Government of India suffers from in this connection arises not from any basic difference of opinion regarding the fundamental issue of repatriation itself but relates chiefly to the consideration how far the cost incurred by the Government for the purpose was reasonably moderate.

The total external debt of India (as already stated, the whole of this was in sterling) on the eve of the present war amounted to three hundred and fifty million pounds, equivalent, in rupees, to four hundred and sixty-five crores approximately. Barring some £2,000, the whole of this was loan at interest. The entire debt was, moreover, funded in character. The debt was owed in three varieties: redeemable loans, irredeemable loans and annuities. The redeemable loans amounted to a little above £96 millions,

or nearly 27·4 per cent. of the total. As is well-known, each redeemable loan has generally two dates assigned to it, an earlier and a later date, and contractually it is not permissible to discharge the loan before the first date, nor to keep it outstanding after the second. Every Indian sterling loan had accordingly its own first optional and final discharge dates and all such dates of all the loans taken together ranged over a period of twenty-seven years, from 1942 to 1968. The second important block of sterling loans consisted of the 'irredeemables,' which amounted to a little above £200 millions. They had, of course, no fixed dates of maturity. This does not mean, however, that they were not subject to repayment at any time. In fact, irredeemable loans are generally repayable after a period fixed in advance, their only distinction lying in the fact that they need not be repaid unless the Government or the issuing authority wants to do so. That is, they are repayable, after the expiry of a stated period, at the option of the debtors and not of the creditors. To repay them, however, the debtor has to give proper notice, usually varying between three months and one year. The outstanding irredeemable loans of India at the outbreak of the war fell into two classes: (1) the ordinary stock and (2) the debenture stock. The ordinary irredeemable loans amounted to £176·4 millions, and consisted of three scrips. One of them, viz., the 3 per cent. loan, of which nearly £77 millions was outstanding was irredeemable until the 5th October, 1948, but could be

redeemed on or after that day upon one year's notice. The two other irredeemable loans, viz., the 2½ per cent., and the 3½ per cent., had already passed the period during which they had been absolutely irredeemable, and were now redeemable upon one year's notice. In the next place, there were the irredeemable railway debenture stocks, the total of which amounted to nearly £25 millions. The railway annuities aggregated to £36 millions. In addition to all this, there was a certain amount of debt owed by India to Great Britain arising out of her contribution to that country during the last Great War. India, it may be recalled, promised Great Britain during the last war a donation of £100 millions.[1] Of this, she paid £83 millions in cash by raising war loans, and for the rest, she assumed the liability of the British Government for its War Loan, 1929-47, which amounted to nearly £17 millions. Of this liability £15½ millions remained due on the eve of the present war.

India's public debt harks back to the days of the East India Company. Up to the last sixties the debt was almost wholly unproductive, and was raised to finance the costly wars waged by the Company within and outside India and to defray the expenses incurred by it to put down the Mutiny.[2] The genesis of the public debt in the eighteenth

1 *Vide* the speech of Sir William Meyer, Finance Member, in the Legislative Council, Government of India, in March, 1917.

2 Of the total debt of India on 30th April, 1862, amounting

century lay in the French Wars in the South and the wars with Mysore. In the nineteenth century, till the abolition of the rule of the Company in 1858, the country enjoyed hardly any considerable respite from war. In the first two decades there were wars with the Marathas and Nepal; in the third, war with Burma; then came the wars with Afghanistan and the Sikhs; and lastly, the Mutiny, which alone cost India forty million pounds. Every fresh war saw India's public debt raised by a cubic foot. In fact, as has been appositely remarked, "the history of India's debt" during the rule of the East India Company "may be described as the history of Indian warfare in its financial aspect."[1] Deficit budgets also contributed to the increase in the public debt. As the Welby Commission appointed by the Crown in 1896 stated,—"From 1838-39 to 1861-62 deficit was the rule and surplus the exception."[2] Borrowing had thus to be frequently resorted to in order to make income reach up to expenditure.

to £97,037,062, or about Rs. 97 crores (at 2s. the rupee), only £5,400,000 was productive debt. *Vide* Report of the Indian Expenditure (Welby) Commission, sec. 117. Regarding the rate of the exchange, see the remark of the Commission in section 123 that in 1867 ten rupees and the pound sterling were convertible terms.

1 *Vide* Dr. P. N. Banerjea, *Indian Finance in the Days of the Company.*

2 *Vide* Report of the Indian Expenditure Commission, sec. 117.

India's public debt during the regime of the Company was raised mostly in India but was held in non-Indian hands. Thus, out of a total debt of £69,473,484 remaining outstanding on the 30th April, 1858, only £8,769,400 was held in England, and the rest amounting to £60,704,084 was held in India. The bulk of the Indian portion of the debt was, however, from the beginning, held by the Company's European servants and English merchants, and at the time when the Company's administration came to an end, it was estimated that not more than one-third of the Indian debt was in the hands of Indians themselves.[1] Outright external indebtedness increased, however, at a fast pace since then, and by 1893 the sterling debt of India had already exceeded the debt raised in India. The following table[2] shows the progress of the rupee and sterling debts of India since 1900:—

PUBLIC DEBT OF INDIA

(In Lakhs of Rupees)

Year ending 31st March	Rupee Debt	Sterling Debt	Total
1900	132,04	186,22	318,26
1905	148,33	199,33	347,66
1910	171,13	264,16	435,29
1913	187,22	268,77	455,99

1 *Vide* Banerjea, *Op. cit.*, p. 121.

2 Figures up to 1935 taken from G. Findlay Shirras's *Science of Public Finance*, Vol. II, pp. 1100-1101. The figure for 1939 taken from the *Statistical Abstract for British India.*

PUBLIC DEBT OF INDIA (*Continued*)

(In Lakhs of Rupees)

Year ending 31st March	Rupee Debt	Sterling Debt	Total
1918	312,26	355,44	667,70
1920	409,67	288,95	698,60
1925	515,09	454,93	970,02
1930	648,30	488,20	11,36,50
1935	725,66	513,36	12,39,02
1939	484,83	464,95	949,78

We have already stated the main cause of public borrowing in India up to the time of the Mutiny. That cause was almost wholly war and warlike operations. Even after the Mutiny, between 1860 and 1900, India's public debt continued to be raised mainly for unproductive purposes. The most important of these was, again, war. Among others were loss on the exchange, deficit budgets, provision for famine relief and the liquidation of the stock of the East India Company.[1] By 1892, however, the productive portion of the debt had already exceeded the deadweight debt and was nearly sixty per cent. of the total. Since, then, in the public debt of India, the weight of the productive debt has been increasingly greater.

1 *Vide* the Minority Report of Sir W. Wedderburn, Mr. Caine and Mr. Dadabhai Naoroji, Members of the Welby Commission, paragraphs 67-71. The fall in the exchange made the Government of India agree to pay "exchange compensation allowance" to its non-domiciled European and Eurasian employees *Vide Ibid.*, para, 74. See also *Report of the Congress Select Committee on the Financial Obligation between Britain and India*, pp. 17-45.

Borrowing for productive purposes may be said to have begun in 1867-68 when the State decided to charge in future expenditure on irrigation and construction of railways to a separate capital account. Earlier than that, no distinction at all was made between productive debt and unproductive debt, and all expenditure was charged to revenue. The growth of the productive debt was, in the beginning, exceedingly small. Towards the end of the century, the increase took place at a rapid pace. Between 1892 and 1906, the Government borrowed every year something like Rs. 4 crores for the purpose of the development of the railways. The year 1906 saw inaugurated an era of railway expansion unprecedented in India's history. Public borrowing on account of railways thereafter reached gargantuan dimensions. The net public debt incurred for railways in 1906 amounted to Rs. 32 crores, whereas in any previous year it had never exceeded Rs. 8 crores. The Committee on the Finance and Administration of Indian Railways (popularly known as the Mackay Committee) recommended an annual expenditure on railways of £12½ millions or nearly Rs. 19 crores. Between 1906 and 1911, the net public debt of the Government of India increased by Rs. 76·02 crores. Of this Rs. 70·21 crores was debt on account of the railways, and Rs. 54·81 crores was debt raised in England. During the last Great War, there was no further public borrowing in England, as the London money market was closed to us. It has been already stated, however, that the war increased

India's external indebtedness by £100 millions or Rs. 150 crores. The next spell of public borrowing began in 1920-21, and during the decade between that year and 1930-31, India's indebtedness in London increased by Rs. 326 crores 79 lakhs. An important cause of heavy public borrowing in England and also in India (although in the latter case on a somewhat reduced scale) during this period was budgetary deficits which in these ten years amounted to Rs. 57·26 crores. Among other contributory causes was the assumption by the Government of India of direct management of the E.I. and the G.I.P. Railways, which involved, along with the taking over of the properties of the Companies concerned, the shouldering of their liabilities as well.

External indebtedness is at best a necessary evil. To a country lacking indigenous capital or with capital market inadequately developed, it is of great importance and may become sometimes indispensable. Foreign debt involving regular interest payment and ultimate repayment of capital creates obligations that can be discharged only in the foreign currency concerned, and this may cause at times considerable difficulties (some of them arising from the problem of transfer) in actual practice. The Government may also be led on to attempt to overvalue the home currency to smooth out their remittance programme, and thus apart from strictly economic factors, a certain amount of speculativeness may enter into the determination of the rate of exchange. It is needless to point out that a country with a large foreign

debt does not have very high international credit. The political demerits of the foreign debt are also considerable. Foreigners become interested in the maintenance of *status quo* in the home country and this may interrupt political development in the case of a backward nation.

The need for the gradual elimination of the sterling debt of India has been long felt by the country. A parliamentary committee admitted as early as 1889 the political and financial reasons which make external borrowing undesirable, and forbade it in the case of India provided the necessary fund was available within the country and the difference between the rate of interest in India and England was not too great. In the present century increase in external indebtedness has been looked upon with growing disfavour by the Indian public and also by the Government of India at least theoretically,[1] but this has not prevented the latter from borrowing large sums in the London market even in recent years. Sometimes it has so happened that the Government has borrowed in the London market at a higher rate of interest than it did in the Indian market in the same year.[2]

1 Sir George Schuster stated as follows in the Indian Legislative Assembly in course of his budget speech for 1929-30: "It is only in so far as money cannot be raised from the investing public in India that I should ever consider having recourse to sterling borrowing." Paragraph 75.

2 Of various instances, mention may be made of borrowing in the years 1921-22, 1927-28 and in 1929-30 the year last men-

THE FIRST STEPS TOWARDS REPATRIATION.

(a) Open market Purchase; (b) Voluntary Transfer.

(a) Open market Purchase.—Repatriation of sterling loans, as distinguished from redemption, was decided upon by the Government of India as a definite step in 1937-38. The most logical step that suggested itself to the Government for the purpose was the expedient of open market purchase. The Government authorised the Reserve Bank to purchase Indian sterling securities in the open market in London in limited quantities as they became available, to be transferred to them later on for cancellation. It may be mentioned in this connection that open market purchase of Indian sterling loans is possible only when the rate of exchange is in our favour. In a normal year, this presents no difficulty at all, for India has usually a favourable balance of trade. The year 1937-38, the first year chosen for open market purchase of Indian sterling loans in London, was not, however, judged from this point of view, a very favourable one. The balance of trade in merchandise and treasure for India and Burma combined decreased in that year to Rs. 43,54 lakhs from Rs. 79,51 lakhs in the previous year. There was also a decrease in the net exports of gold, but this was more than offset by a decrease in the net imports of silver. The result of the fall in the favourable balance of

tioned being that in respect of which Sir George Schuster made the speech quoted in the preceding footnote.

trade was that less sterling was available to the Reserve Bank for purchase. The total purchase of sterling by the Reserve Bank of India in 1937-38 amounted to only £25,140,000 as compared with £53,532,000 in the previous year, and was less than even the current requirements of the central and provincial Governments. The Bank had, however, already built for itself a large reserve of sterling as a result of operations in the previous years, and this enabled it not only to supply current needs, but to finance the limited measure of repatriation with which it was entrusted by the Government of India. A special factor helping repatriation in 1937-38 was the appreciably lower market prices of the Government of India sterling securities as compared with those of the corresponding rupee securities.

The nominal value of the Indian sterling securities purchased in the open market in London in 1937-38 was £2,990,000, and it was made up as follows:—

Loans	Nominal value.
	£
5% Loan 1942-47	510,000
4% Loan 1948-53	645,000
3% Loan 1949-52	500,000
4½% Loan 1950-55	495,000
3½% Loan 1931 or after	600,000
3% Loan 1948 or after	240,000
	£2,990,000

The Government paid off the value of the terminable loans from their current resources but replaced the £840,000

of non-terminable stock by 3½% and 3% rupee paper of the same nominal value (Rs. 1·12 crores). The purchase price of the non-terminable stock was £0·75 million or Rs. 1 crore. The rupee counterparts were gradually issued to the public by the Reserve Bank of India according to the absorptive capacity of the market.

In the next year, viz., 1938-39, the Government were compelled to suspend their repatriation operation due to continued slackness in the remittance programme to which reference has already been made. In spite of this, however, the Government of India was able during this period to liquidate completely their liabilities in connection with the Family Pension Funds amounting to £9½ millions.[1]

The outbreak of the war swept away all difficulties connected with the question of remittance, and in a sense clinched the whole issue of repatriation. The prodigious growth of sterling in the vaults of the Reserve Bank of India since hostilities broke out has been conditioned by two factors. They are, firstly, the rapid shrinkage of import trade, due to (a) the pre-occupation of the exporting countries with war operations, (b) the greatly increased dangers of the sea-route and (c) the fact that some countries from which we used to obtain large supplies became enemy countries; and secondly, the growth of the export trade of India due to the fact that India became with the progress

1 Vide *Report on Currency and Finance for the Year 1939-40*, pp. 19-20.

of the war an important base for supply of various essential war materials and food-stuffs to His Majesty's Government for which she was paid not in her own currency, the rupee, but in sterling in London. The immediate rupee finance has been made the responsibility of the Government of India leading to large expansion of the internal currency. About the nature of the sterling balance in London and the effects of the currency expansion on internal economy, more will be said later on.

The following table[1] shows the growth of the sterling assets of the Reserve Bank of India since 1935-36:—

STERLING ASSETS OF THE RESERVE BANK OF INDIA

Annual Average	Sterling Securities held in the Issue Department.	Balance held Abroad (Banking Department).	Total.
	(Rs. Lakhs)	(Rs. Lakhs)	(Rs. Lakhs)
1935-36	62,13	15,05	77,18
1936-37	69,63	13,76	83,39
1937-38	79,90	13,39	93,29
1938-39	66,88	4,12	71,00
1939-40	78,32	12,19	90,51
1940-41	129,97	39,47	139,44
1941-42	165,44	45,94	211,38

1 Based on statistics in the *Report on Currency and Finance for the Year 1941-42*, pp. 91 and 93.

The gross accumulation of sterling in the Issue and Banking Departments of the Reserve Bank of India since the outbreak of the war is indicated in the following analysis [1]:—

1.	Total Sterling Assets held by the Reserve Bank in August, 1939	64
2.	Sterling purchased by the Reserve Bank	
	September, 1939—March, 1940	86
	April, 1940—March, 1941	76
	April, 1941—March, 1942	98
3.	Sterling Recoveries from His Majesty's Govenment	258
		582

It is hardly any wonder, therefore, that the question of repatriation was re-opened soon after the outbreak of the war. The Government of India, in pursuance of the policy already adopted, authorised the Reserve Bank to purchase on their behalf non-terminable Indian sterling loans in the London market on favourable terms, and to transfer the scrips to themselves for cancellation against the issue of additional rupee paper of 3 and 3½ per cent. non-terminable loans. This additional rupee paper would be held by the Bank till it thought fit to re-issue the same to the public according to the requirements and absorptive capacity of the market.

1 Vide *Report on Currency and Finance for the Year 1941-42*, p. 20.

The first cancellations. under these arrangements, took place on the 15th November, 1939. The total value of the non-terminable sterling loans repatriated in 1939-40 amounted to £9,337,500, being made up of 3% India Stock 1948 of the value of £3,712,500 and 3½% India Stock 1931 of the value of £5,625,000. The rupee counterparts issued against them amounted to Rs. 12,45,00.000 consisting of 3% Paper 1896-97 for Rs. 4,95,00.000 and 3½% Paper 1842-43 for Rs. 7,50,00.000.,

(*b*) *Repatriation by Voluntary Transfer:*—This was followed up on the 22nd February, 1940, by the announcement of a further scheme of repatriation which was, however, limited only to the loans of the terminable variety. The scheme consisted in the creation of the following rupee loans as counterparts of sterling loans noted against each.

	Rupee Loans			Sterling Loans			
(1)	3%	Loan	1949-52	3%	India	Stock	1949-52
(2)	3½%	"	1954-59	3½%	"	"	1954-59
(3)	4%	"	1948-53	4%	"	"	1948-53
(4)	4½%	"	1950-55	4½%	"	"	1950-55
(5)	4½%	"	1958-68	4½%	"	"	1958-68
(6)	5%	"	1942-47	5%	"	"	1942-47

Holders of the sterling loans were given the option,[1] with effect from the first April following, and until further

1 For details of the terms of conversion, see the Memorandum issued by the Reserve Bank of India, dated the 27th February, 1940.

notice, of transferring their holdings from the books of the Bank of England to the rupee registers of the Reserve Bank of India at various centres. The rupee counterparts, once issued, would not be reconvertible into sterling, but they might, as in the case of other rupee loans, be enfaced for the payment of interest in sterling at the London Office of the Reserve Bank of India.

The Reserve Bank of India was also authorised to purchase terminable sterling loans in the open market. This resulted in the cancellation of such loans valued at £7,755,000 during 1939-40 against which rupee counterparts were issued of the value of Rs. 10·34 crores. The tables[1] which follow show (a) the various terminable sterling loans cancelled through open market purchase in 1939-40 and (b) indicate also the rupee counterparts issued against each.

Table I

Sterling Loans Cancelled				Total £
3%	India Stock		1949-52	412,500
3½%	"	"	1954-59	150,000
4%	"	"	1948-53	772,500
4½%	"	"	1950-55	2,145,000
4½%	"	"	1958-68	1,042,500
5%	"	"	1942-47	3,232,500

1 Vide *Report on Currency and Finance for the Year 1939-40*, pp. 19-20.

Table II

Rupee Loans (Counterparts Issued)				Rs. Crores Amount
(1)	3%	Loan	1949-52	·55
(2)	3½%	,,	1954-59	·20
(3)	4%	,,	1948-53	1·03
(4)	4½%	,,	1950-55	2·86
(5)	4½%	,,	1958-68	1·39
(6)	5%	,,	1942-47	4·31

The scheme of repatriation through voluntary transfer came into effect on 1st April, 1940. It may be stated, however, that this scheme could not appeal much to non-Indian investors, who, indeed. stood to gain precious little from it. In fact, the transfer would mean the subjecting of their interest income from these loans to the fluctuations and exigencies of the rupee-sterling rate of exchange. In normal times, the fluctuations are negligible, but they cannot be entirely ruled out. Though provision was made for the payment of interest in sterling through enfacement, the interest would be earned in rupees in the first instance, and then converted into sterling at the ruling rate of exchange about which there could be, of course, no guarantee. Reference may also be made in this connection to the various proposals emanating from time to time from influential non-official quarters in India for the under-valuation of the rupee. In the case of anything coming out of such proposals, the loss to the non-Indian investors would be far more serious and heavy.

The total sterling loans repatriated through the new licence scheme in 1940-41 amounted to £2·02 millions, and the rupee counterparts issued against them were of the value of Rs. 2·69 crores. It may be mentioned in this connection that to the Government of India every such transfer was highly welcome if only because the interest payable on account of a rupee counterpart would be subject to the Indian income-tax at source, whereas the income from the Indian sterling loans would not. A much larger quantum of cancellation was effected through open market purchase, which secured in 1940-41 £9·22 millions at a cost of £8·52 millions (equivalent to Rs. 11·36 crores) against which counterparts were issued amounting to Rs. 12·10 crores.

A debtor government is always free to purchase its own loans in the open market, if available, and it also becomes expedient to do so when this can be done on favourable terms. An essential pre-requisite of open market purchase is, however, the availability of ready cash. The ready money need not be in the actual possession of the Government: it is enough if it is in the possession of the Central Bank and can be made available to it. When the loan to be purchased in an external one, the ready cash must be in the form of the foreign currency concerned. India rapidly qualified for this condition with the progress of the war. The policy of open market purchase suffers, however, from the limitation that it cannot be long kept secret, which is almost an essential condition for its success, and once the

buyers get to know about it, they sit tight on their holdings. In such an event, either the Government must retreat from the market, or they have to purchase the loans at a heavy and undue cost to themselves. The voluntary transfer scheme of 22nd February, 1940, was entirely free from this blemish: because it was voluntary. Under it nobody would need part with his scrip unless he himself so chose. The scheme had the further advantage of financing itself. Cash payments were substituted by the rupee counterparts which served for direct payment. For reasons stated, however, the scheme failed to have much appeal to any but Indian investors. The gain of the latter from the scheme, however, need be emphasised, and there can be no doubt that of those who actually took advantage of the scheme, Indian investors formed by far the largest group. The gain of the Indian investors not only consisted in the availability of their assets nearer at hand, but they also stood to gain in so far as the rate of the Indian income-tax might be lower than the rate obtaining in Britain. Moreover, the fact that Government securities are usually quoted in the Indian market at a somewhat higher price than similar securities in the London market made it likely that the Indian investors could also hope to derive some gain from capital appreciation when the counterparts came to have a market of their own.

Open market purchase is the normal course open to a debtor government willing to repatriate its external loans in

an expeditious manner. A more conservative course would be to await, and avail of when arrived, the first optional date of redemption. But this can hardly meet the clamant need of a nation bent upon riddance of external debt. India tried open market purchase and voluntary transfer only in the first stages of repatriation. For quicker and more effective result, she took finally to compulsion, as we shall see later on. Her example was followed by other empire countries.

Up to 31st March, 1941, India purchased through the policy of open market purchase Indian sterling loans of the face value of £27·15 millions[1] at a purchase price of £25·81 millions. Of these, the purchases made in 1937-38 were insignificant, amounting to £0·84 millions (face value). The rest were purchased in 1939-40 and 1940-41, and the greater part of the purchases in these two years were made between March and October, 1940.

We may stop here a little to ask the question how far the Government of India and the Reserve Bank were able to effect their open market purchases on terms favourable to themselves. We have already hinted at some of the dangers attending the purchaser in the open market. If he lets his secret go, it is not likely that he will make a bargain. It has been alleged against the Government of India and

1 This ignores the terminable sterling loans cancelled in 1937-38 for cash payment.

the Reserve Bank that they made their open market purchases in London with so much noise that their action had the effect of raising the prices of the securities against themselves, thus inflicting a heavy loss on the Indian exchequer. This criticism has been strongly controverted by both the authorities concerned. In his budget speech for 1942-43 Sir Jeremy Raisman, Finance Member to the Government of India, said: "There has been criticism in some quarters that the open market purchases made from time to time before the first compulsory repatriation pushed the prices against us, and, therefore, made the scheme unduly expensive. This criticism is not valid because the bulk of our purchases were made during March to October, 1940, when security prices had slumped as a result of international situation, and the prices paid were close to the minima fixed by the London Stock Exchange." This same argument is repeated by the Reserve Bank of India in the Report on Currency and Finance for the year 1941-42. "The bulk of the open market purchases in 1939-40 and 1940-41," says the Report, "were made between March and October, 1940, when the prices were near the minima fixed by the London Stock Exchange."

These statements however, are true only to the letter, and gloss over a very important fact. On March 18, 1940, the London Stock Exchange Committee did not *fix* so much minimum prices of certain British and Indian funds as *raised* the minima fixed months back in August, 1939. The revised

minimum prices of March 18, 1940, as compared with the minima of August 1939 were as follows:—

Minimum Prices Fixed for Indian Sterling Loans[1]

Loan		August 24, 1939	March 18, 1940
		£	£
India 2½%		55½	67
" 3%	1948	66¼	79
" 3%	1949-52	90½	96
" 3½%		79¼	91½
" 3½%	1954-59	92¼	100
" 4%	1948-53	98	104
" 4½%	1950-55	101¾	107
" 4½%	1958-68	102¾	109
" 5%	1942-47	101	103½

The minimum prices of August 24, 1939, which were the same as the lower or "bid" prices quoted in the London Stock Exchange Official List for August 23, 1939, were fixed under the shadow of an impending international crisis. The Russso-German non-aggression pact had been announced three days earlier, and had been signed in Moscow the day preceding. Germany was moving openly on the war path and everybody knew that if Hitler struck Poland, the whole magazine house of Europe would be immediately aflame. The effect of these great happenings and sinister fore-

1 Vide *The Economist* for March, 23, 1940.

bodings on the London Stock Exchange can be very well imagined, and it was in fact already suffering from occasional shocks of panic. Closely at the heels of the minimum prices came the doubling of the bank rate from 2 to 4 per cent. The resulting confusion contrasts very sharply with the situation in March, 1940. The world had not yet had any inkling of the coming collapse of France and other reverses. For the time being there seemed to be a calm assurance in the political atmosphere, false though it proved to be. Various peace feelers emanating from Berlin *via* neutral channels also helped the further misreading of the situation. Be that as it may, the fact remains that in March, 1940, the London Stock Exchange felt assured enough to raise the minimum prices. Thus Sir Jeremy Raisman can hardly claim credit for the fact that the bulk of the open market purchases in 1939-40 and 1940-41 were made during March to October, 1940, in view of the fact that this was not certainly the period during which the prices of the loans were the lowest, or even particularly low. The new minimum prices fixed in March 1940, near about which the Government claim to have purchased the loans, were not only higher than the scale of minimum prices prevailing in the immediately preceding period (August 24, 1939 to March 18, 1940) but were higher than even the prices ruling on August 1, 1939, when there was no official control of the prices at all. The following table illustrates this point:—

INDIAN STERLING LOANS

Prices in the London Market[1]

Loan		August 1, 1939 (closing rates)	Minimum prices fixed on March 18, 1940
		£	£
India 3½%		84½	91½
" 3%		72	79
" 2½%		60¼	67
" 4½%	1950-55	108	107
" 4½%	1958-68	110¼	109
" 5%	1942-47	106	103½
" 3½%	1954-59	96½	100
" 4%	1948-53	102½	104
" 3%	1949-52	94½	96

In the next place, Sir Jeremy Raisman's statement that the prices of the Indian sterling loans stood near the officially fixed minima during March to October 1940 is not wholly correct. The statement is valid not for the entire period but for the period from the middle of May to October. That the prices of *all* the Indian sterling loans rose appreciably above the minima by the middle of May 1940 is shown beyond any possibility of doubt by the following table.

1 The first six quotations are taken from the *Times*, London, for August 2, 1939, and the remaining three are taken from *The Statesman*, Calcutta, of the same date.

MARKET QUOTATIONS OF INDIAN STERLING LOANS IN 1940

Loan		Minimum Prices, March 18, 1940	Market Prices, May 13, 1940
		£	£
2½%		67	69
3%		79	82
3½%		91½	95
4½%	1958-68	109	113½
4½%	1950-55	107	110½
5%	1942-47	103½	107
4%	1948-53	104	107¼
3½%	1954-59	100	102 3/8
3%	1949-52	96	98¼

Thus we find that the statement of Sir Jeremy Raisman and of the Reserve Bank of India are alike vitiated by the defect of *suggestio falsi.*

CHAPTER III

FROM DEBTOR TO CREDITOR (I)

A new chapter was opened in the history of repatriation of sterling loans when on the 8th February, 1941, the Government of India announced that they had taken action. with the concurrence of His Majesty's Government, to acquire on a compulsory basis the whole of India's outstanding sterling loans of terminable variety. The face value of such loans at the date of the Order was estimated to be £84 millions, and their market value amounted to nearly £90 millions.

In making this announcement the Government of India set an example and a precedent. Previously, some Dominions had liquidated portions of their sterling loans, but the method adopted by them was not compulsion but outright purchase of matured loans prior to the last date of option. India's action was, therefore, in a sense. revolutionary.

Before we proceed to evaluate the economics of compulsory repatriation, let us set in the background the amount of sterling loans repatriated earlier through the ordinary channels of a free market. The following table sets forth, year by year, the sterling loans repatriated prior to the Order of February 8, 1941 :—

REPATRIATION OF STERLING LOANS
(Up to 8th February, 1941)

Sterling Loans Cancelled		Amount (£. millions)	Rupee Counter-parts (Rs. Crores)
1937-38	through open market purchase	0·84	1·12
1938-39		...	...
1939-40	through open market purchase	17·09	22·79
1940-41	(a) through open market purchase	9·22	12·10
	(b) through licence system	2·02	2·69
	Total	29·17	38·70

Pros and Cons of Compulsion.—Compulsory repatriation is a drastic step, and it involves a breach of the contract. It embarrasses the foreign investor, who has to find out a new means of profitable disposition of capital. As a scheme of repatriation is likely to be taken up at a time when the long-term rate of interest is low, it may be fairly presumed that the investor will not be able to reinvest his funds to the same advantage to himself. This criticism, however, properly applies to compulsory repatriation made on the basis of the face value of the loans acquired, and hardly affects the Government of India which paid for the Indian

sterling loans held by the London investor at market, as distinguished from face values. For, though the British investor would have to lay out the sterling released from the Indian loans into other current loans available in the London market, and offering much lower interest yields. he would hardly suffer in respect of total interest earned because of the premium received on the face value of the scrips he was made to surrender . This argument overlooks the consideration, however, that the market value of scrips may not always be representative of their true strength, and may be sometimes unduly depressed by temporary reasons. Were this to be so at the time repatriation was effected, acquisition at even market rates would leave the investor very much of a grievance.

Compulsion can be justified only by great necessity. It may be defended only when it is absolutely indispensable. Much can be said for it. however, when it may conduce to some national interest of the creditor country, though not to the interest of the individual creditors. In this respect India's schemes of compulsion acquit themselves very well. In fact, they have been conceived as much in the interest of Great Britain as of India. Indeed. it has been freely acknowledged by responsible British officials and also by the British Press that India's action in this regard has been greatly helpful to the war effort of Britain. *The Economist* of London has gone further to point out that the repatriation was advantageous also to the London bill

market.[1] Be that as it may, there is no doubt that the large sterling resources thrown on the London market by compulsory repatriation were driven by the inexorable logic of the situation to the support of the defence issues of the British Government. Sir Jeremy Raisman admitted this in so many words in his budget speech for 1941-42. *The Economist* of London, as already stated, drew attention to an aspect of the repatriation operation left out of consideration by Sir Jeremy Raisman. It showed that not the British Government alone, but the London discount market also stood to gain from the repatriation in that it hoped to receive in future larger allotment of British Treasury Bills and that, too, at more favourable rates than before, on account of lessened competition for the same from semi-official sources such as the Reserve Bank of India. It may be pointed out in this connection that so long as the Reserve Bank of India held in London a large stock of sterling which its special position prevented it from locking up in long-dated loans, it could not but take advantage of earning ever so little percentage on it by investing it in such ideal short-term funds as the British Treasury Bills. We should remember at the same time, however, that this action of the Bank, however desirable in its own interest, could not be very welcome to the London bill market to which the emergence of an additional competitor meant both a stiffening of the discount rate as well as shorter allotment for itself.

1 *Vide The Economist* for February 15, 1941, p. 219.

We are not arguing that the Government of India would have a natural right to have recourse to compulsion only if the deal might prove to be not unfavourable to the British interest. Compulsion became, in fact, possible only with the help of very large special powers assumed by the Government in Britain and India under various defence regulations.

It is under such special authority that an Order was issued by His Majesty's Government on the 7th February, 1941, requiring all residents of the United Kingdom holding any of six specified terminable sterling loans of the Government of India to surrender the same to themselves by the 10th March following for prices laid down in the Order. The prices referred to were based on the market prices on the day of the Order plus compensation (i.e. interest) for the inevitable slight delay which would be involved in making the actual payment. Payment, subject to good delivery, was expected to commence on the 24th March. The six loans specified in the Order were all the terminable sterling loans of India then outstanding. viz., (1) 5% India Stock, 1942-47, (2) 4½% India Stock 1950-55, (3) 4½% India Stock 1958-68, (4) 4% India Stock 1948-53, (5) 3½% India Stock 1954-59 and (6) 3% India Stock 1949-52.

Following the above, a supplementary Indian Vesting Order was issued by the Government of India on the next day (8th February, 1941) compulsorily vesting in them-

selves, under sub-rule (3) of Rule 94 of the Defence of India Rules, all outstanding stocks of the above-mentioned loans held by residents in British India at prices which were the same as those mentioned in the British Order. Residents in India were, however, given the option of accepting, instead of cash, rupee counterparts, issued at par, of the loans cancelled.[1] This meant that for every £7 10s. of the scrip surrendered counterpart would be received of the value of Rs. 100 nominal.

The acquisitoin prices of the six loans requisitioned, under the British and Indian Vesting Orders respectively, are shown in the following table:—

Stocks	Price per Security of £100 nominal payable in Britain[2]			Price per Security of £100 nominal payable in Britain[3]		
	£	s.	d.	Rs.	As.	P.
5% India Stock 1942-47	104	16	6	1,397	11	0
4½% India Stock 1950-55	110	1	10	1,467	14	0
4½% India Stock 1958-68	112	17	0	1,504	11	0
4% India Stock 1948-53	106	11	7	1,421	1	0
3½% India Stock 1954-59	102	16	4	1,370	14	0
3% India Stock 1949-52	99	16	2	1,330	12	0

1 See "Statutory and Other Notices issued by the Government of India and the Reserve Bank of India regarding matters relating to the Trade and Commerce of British India in connection with the War," Sixth Series, pp. 71-72.

2 See *Report on Currency and Finance for 1940-41*, pp. 30-31.

3 Vide *The Gazette of India*, January-June, 1941, p. 114.

Actual payments in connection with the repatriation operation began, as already indicated, on the 24th March, 1941.

Sterling loans paid off, or repatriated, under the Order of February 8, 1941, by the end of the financial year 1940-41 amounted to £60·05 millions. The following table illustrates the nominal and acquisition values of the loans cancelled in the United Kingdom and India respectively:

Total Sterling Loans cancelled	Nominal Value £ (000's)	Nominal Value Rs. (000's)	Acquisition Value £ (000's)	Acquisition Value Rs. (000's)
U.K.	54,024	72,03,00	58,621	77,76,12
India.	6,025	8,03,34	—	8,51,19

By the 28th April, 1941, the repatriation operations in terms of the Order of the 8th February preceding had been nearly completed.[1] The total face value of the outstanding terminable loans surrendered and cancelled by that date under the U.K. Vesting Order amounted to £56·77 millions. The face value of stock surrendered but not yet cancelled was £2 millions. Under the Indian Vesting Order, sterling stock of the face value of £8·5 millions had been already cancelled, and £2·17 millions had been surrendered, but had yet to be cancelled. Thus, in total, £70 millions worth of sterling loans had been already cancelled,

1 *Vide* "Statutory and Other Notices, etc.," 7th Series, pp. 76-77.

of which £59 millions (in round figures) had been loans held in the United Kingdom, and £11 millions had been held in India. The amount of further stock cancelled in 1941-42 was not considerable, and by the end of the financial year 1941-42 the total face value of the terminable sterling stock repatriated under the first compulsory scheme of the 8th February, 1941, amounted to £73·13 millions. Recalling in this connection that the total terminable sterling loans outstanding on the 8th February, 1941 were £84 millions, we find that loans worth £11 millions (about Rs. 15 crores) escaped the scheme of compulsion. Presumably, these loans were held by non-residents outside the application of the U.K. and Indian Vesting Orders and there can be very little chance of their being repatriated till the hostilities end.

The total purchase price of the £73 and odd millions of sterling stock repatriated under the above scheme was £78·84 millions (equivalent to Rs. 105·12 crores) and the rupee counterparts issued against them amounted to Rs. 97·51 crores.

The rupee finance of that part of the sterling stock which was held by the Indians presented no difficulty at all, as payment was demanded almost wholly in counterparts and not in cash.[1] In fact, of Rs. 14,56 lakhs of sterling stock dealt with under the Indian Order, 'loans for

1 Vide Finance Member's Budget Speech for 1942-43, para. 33.

Rs. 13,30 lakhs were acquired in exchange for counterparts, and only the small balance had to be redeemed in cash. The remaining sterling loans amounting to about £64 millions (Rs. 84 crores) which were dealt with under the British Order, presented, no doubt, much greater complications. They involved a cash payment of £66·3 millions. The first problem was the acquisition of so much of ready sterling. This, however, was greatly facilitated, as we have already seen, by the already abnormal accumulations of sterling with the Reserve Bank of India owing to the special circumstances of the war. The real problem, then, lay in the rupee finance of the sterling acquired from the Reserve Bank. One possible course would be to borrow the entire amount that was needed from the market. But various considerations held the Government from adopting it. In the first place, it was feared that the amount itself might be too big for the absorptive capacity of the market. Secondly, the Government had also to take into consideration the possible shock to the rupee security market of such a huge loan transaction.[1] Moreover, it was also certain that the loan expedient would affect the defence loan operations of the Government to a certain extent at least. Finally, the issue of such a large amount of capital to the market at a very short notice would also be inconsistent with the Government's own policy of maintaining cheap money condi-

1 Vide Finance Member's Budget Speech for 1942-43, para. 35.

tions.[1] All these difficulties pointed to the improvisation of the counterparts. Except for small amounts issued to Indian investors, the counterparts were at first withheld from the public, the Government and the Reserve Bank holding them, pending final arrangements, almost in equal proportions. A portion of the finance was also provided by the issue of *ad hoc* treasury bills to the Bank.[2] Some amount of ways and means advance from the Bank and cash resources to some extent gave the finishing touches to the provision of rupee finance.

The *ad hoc* treasury bills referred to above were gradually replaced by sterling as the same began to accumulate to the credit of the Government of India on account of recovery of war expenses. By the time the Government undertook their second scheme of compulsory repatriation in December, 1941, the amount of *ad hoc* treasury bills held by the Reserve Bank of India in its Issue Department had fallen to Rs. 2·71 crores only. The rupee counterparts held on Government account were gradually issued to the market according to its absorptive capacity.[3]

1 Vide Finance Member's Budget Speech for 1941-42, para. 34.

2 The practice of issuing currency notes against treasury bills began during the last war in 1918. See in this connection the *Report of the Controller of Currency* for 1923-24, p. 24.

3 See Report on Currency and Finance for the Year 1941-42, p. 38. Also Central Budget for 1942-43. Finance Member's speech para 36.

CONVERSION OF COUNTERPARTS

It has been already stated that rupee counterparts of a total value of Rs. 97½ crores had been created by the Government of India as a result of the repatriation operations just described up to the end of 1941-42. Of these counterparts the amount held by the public was exceedingly small amounting to about Rs. 13·30 crores. The rest were held by the Reserve Bank and the Government of India almost in equal proportions. This could be, indeed, only a short-term arrangement. We have already stated the various reasons which prevented the Government from releasing these counterparts to the market in substantial quantities all at once but the Bank and the Government could hardly be expected to retain with them for long such huge frozen resources, and, as both the authorities freely acknowledged, the very fact of the existence of such a large amount of apparently unsaleable stock could not but have a depressing effect upon the security market. Moreover, the counterparts ate into the Government's cash balances, which was a disadvantage during a period of war of greater moment than the gain from the temporary freedom from liability to pay interest. The counterparts were also undesirable as assets of the Reserve Bank because they were not sufficiently liquid. They also led to a change in the composition of the paper currency reserve of the Bank. Under the Act of 1934, the Reserve Bank could hold as reserve against note-issue rupee securities not exceeding one-fourth of the total

issue or Rs. 50 crores, whichever was higher. The Bank could exceed this limit in special cases, with the previous permission of the Central Government, by an amount not exceeding Rs. 10 crores. The large-scale substitution of rupee counterparts for sterling securities went beyond both these limits and made necessary the passing of an Ordinance legalising the new position. The Ordinance which was passed on the morning of the 8th February, 1941, raised the maximum proportion of the rupee securities to the total currency reserve to three-fifths, and not less than two-fifths was to consist of gold coin or bullions or sterling securities.[1] Thus the ceiling of Rs. 50 crores of rupee securities was abolished. It should be noted however that the only effect of the Ordinance was to grant immunity to the Reserve Bank from an infringement of law, which would otherwise take place, but could not certainly make the counterparts more desirable than they already were from financial and banking points of view.

We may, therefore, easily understand the anxiety of the Government and the Reserve Bank to do something positive at an early date to regularise the position of these counterparts and to place them on the same footing of marketability as other Government loans. In his budget speech for 1941-42, Sir Jeremy Raisman, the Finance Member,

1 See the *Gazette of India Extraordinary*, Jan.-June, 1941, p. 113 and Press Communique dated the 8th Feb., 1941, in *Statutory and other Notices, etc.*, Sixth Series, pp. 70-71.

fully explained the Government point of view in this respect. He explained the considerations which led to the improvisation of the counterparts and held out promise of a decision, as early as possible, on more permanent arrangements.

The first definite step taken by the Government to implement the promise of a more permanent arrangement was announced on the 9th June, 1941.[1] Holders of two of the rupee counterparts (viz., the 4½% loan, 1950-55 and the 4½% loan, 1958-68) were given the option of converting their holdings, between the 16th and the 21st June following, into two existing rupee loans. Option was granted to convert the 4½% rupee counterpart 1950-55 into the 3% loan 1951-54 issued in 1938 and to convert the 4½% rupee counterpart 1958-68 into 3% loan 1963-65. For the purpose of conversion the issue price of the 3% loan 1951-54 was fixed at 100 and that of the 3% loan 1963-65 at 95. The Government offered to accept the 4½% rupee counterparts 1950-55 at the rate of Rs. 110-12-0 per Rs. 100 (nominal) of the securities surrendered and the 4½% rupee counterparts 1958-68 at the rate of Rs. 113-8-0 (cash equivalent) per Rs. 100 (nominal) of the securities tendered.

Th total terminable sterling stock repatriated up to the time of the above-mentioned notification under the compul-

1 See the *Gazette of India Extraordinary*, Jan.-June, 1941, pp. 341-42.

sory scheme of the 8th February preceding amounted to £69,628,300 made up as follows[1]:

	£
5% stock 1942-47	4,759,200
4½% stock 1950-55	29,534,800
4½% stock 1958-68	12,253,700
4% stock 1948-53	8,289,600
3½% stock 1954-59	7,630,300
3% stock 1949-52	7,160,700
	69,628,300

The face value of the rupee counterparts created against the above amounted to Rs. 92·84 crores, and of this the amount held by the public was only Rs. 12·52 crores. The option of conversion was extended not to all the loans, but to the two 4½% loans only totalling nearly £42 millions, or Rs. 56 crores. As most of the scrips of these loans were held by either the Government or the Reserve Bank, the success of the conversion operation was a foregone conclusion.

The terms of the conversion were so fixed that there could not be any loss on transfer. The issue prices of the two 3% loans were in accord with their market prices at the time of the notification and the cash equivalents of the two 4½% counterparts were also at parity with market

1 Vide "*Capital*," for June 11, 1941, p. 867.

prices of similar loans at the same time. This can be seen at a glance from the following table:—

Loans	Issue Price	Market Price	Cash equivalent
3% 1963-65	95	95 2 6 (7th June, 1941)	
3% 1951-54	100	99 12 6 (2nd June, 1941)	
4½% 1950-55 (rupee counterpart)	...		110 12 0
4½% 1958-68 (rupee counterpart)	...		113 8 0
4½% 1955-65	...	112 8 0 (6th June, 1941)	

The investor, taking advantage of the conversion offer, would, far from incurring a loss, be a gainer in certain respects. He would gain first from the greater marketability of his stocks. The 4½ per cent loans on account of their heavy premiums were definitely unsaleable, while, on the other hand, the 3 per cent. scrips into which conversion was offered had active markets. Moreover, the investors holding the 4½% loans would have to provide for amortisation out of current interest earnings—a course which, however simple in theory, is inconvenient and often unattainable in practice and liable thus to result in a frittering away of capital values. The 3% loans which stood much nearer to their redemption values than the 4½% rupee counterparts were also better adapted to the requirements of institutional investors such as banks and insurance companies. Lastly,

investors taking advantage of the conversion offer would also gain from the fact that the conversion prices of the 4½% 1950-55 and 4½% 1958-68 loans, viz., Rs. 110-12-0 and Rs. 113-8-0 respectively, were, as was pointed out by *Capital*, "exactly one rupee per cent higher than the prices at which they were taken over when the sterling stocks were repatriated."[1]

The total face value of the two 4½% rupee counterparts converted in terms of the above-mentioned notification amounted to Rs. 28·56 crores, being made up of 4½% rupee counterpart 1958-68 amounting to Rs. 13·4 crores and 4½% rupee counterpart 1950-55 amounting to Rs. 15·16 crores. As a complementary transaction, the Government also cancelled stocks amounting to Rs. 21·76 crores of the 4½% 1950-55 rupee counterparts which were either held by them or were purchased for cancellation from the Reserve Bank. Thus, of Rs. 56 crores worth of the 4½% rupee counterparts outstanding on the eve of the conversion offer, Rs. 50·32 crores were already converted or cancelled. Of the balance amounting to nearly Rs. 6 crores a portion presumably remained in the hands of the public who failed to take advantage of the conversion offer, and the remaining scrips were held by the Government to ensure the marketability of the scrips retained by the public. It may be mentioned in this connection that the conversion operation effect-

1 Vide "*Capital*," for June 19, 1941, p. 907.

ed an increase in the outstanding stocks of the 3% loans 1951-54 to Rs. 31·91 crores from Rs. 15·13 crores and an increase in the outstanding stocks of the 3% loans 1963-65 to Rs. 48 crores from Rs. 32 crores. Thus, the total nominal value of the two 3 per cent loans issued against the two 4½% counterparts amounted to Rs. 32·80 crores.

In addition to the conversions and cancellations noted above, the Government also effected the following cancellations of some of the other rupee counterparts:—5% 1942-47, nearly Rs. 10·73 crores; 4% 1948-53 about Rs. 9·48 crores; 3% 1949-52, Rs. 4·14 crores. Thus we find that of nearly Rs. 93 crores of rupee counterparts created as the result of compulsory repatriation, Rs. 46·11 crores had been already cancelled by the Government and Rs. 28·56 crores had been converted.

The net result of repatriation, conversion and cancellation at the end of 1941-42 may be stated as follows. The rupee debt of the Government of India increased by Rs. 92 crores and interest charge payable in rupees by Rs. 3 crores. On the other hand, sterling debt fell by Rs. 135 crores and interest payable in sterling by Rs. 5½ crores. The position regarding rupee counterparts at the end of December, 1941, stood thus: Of nearly Rs. 140 crores of rupee counterparts created since repatriation was first undertaken, nearly Rs. 48 crores had been cancelled, Rs. 51 crores were in the hands of the public, a little over Rs. 31 crores were held by the Reserve Bank and Rs. 9⅔ crores were

held on Government account. The cash payments on account of the counterparts cancelled were almost entirely financed by defence loan receipts as the treasury bill outstandings of the Government of India had actually declined (by Rs. 14 crores) between 1st March, 1941, when repatriation payments had not begun, and the end of January, 1942. Thus Sir Jeremy Raisman could say with pride in the course of his budget speech for 1942-43 that the bulk of the floating debt incurred for financing the first instalment of repatriation had already been funded.[1]

A CRITIQUE OF REPATRIATION OPERATIONS

A salient point of difference between liquidation of sterling loans through open market purchase and that through compulsory acquisition is that while in the former case the loans were purchased, speaking on the whole, for less than their face values, in the case of compulsory acquisition, the price paid was, on the whole, considerably above face values. Thus, while up to the 31st March, 1941, the Government of India purchased in the open market £27·15 millions of Indian sterling loans for £25·81 millions, under the scheme of compulsion, their expenditure amounted to £78·84 millions for acquiring loans valued at £73 and odd millions. We would not be justified, however, to jump from the mere fact of the premium paid to the conclusion that the same was unconscionable.

1 Para. 36.

The Government of India have been subjected to the criticism that the prices they paid for the Indian sterling loans under the scheme of compulsory acquisition were extortionate and a resolution was passed by the Indian Legislative Assembly on the 12th November, 1941, recommending to the Governor-General-in-Council that "in any fresh scheme of the repatriation of India's sterling debt, care should be taken to see that the cost of such repatriation on India's revenues is not unduly heavy.[1]

How far does the Government of India really merit the censure implied in the above resolution? It will be now our task to probe into this question in right earnest.

The main argument of the critic of the Government is that the Government chose to use their powers of compulsion at a moment when the prices of the loans happened to be particularly high as a result, it is further alleged, of the Government's own misguided policy of pushing on with open market purchase in the face of a market increasingly hostile.

Now, in addressing urselves to the question how far the Government of India could have liquidated the above-mentioned loans earlier, it would help clear thinking to bear in mind certain considerations. It is not enough for the critic indicting the Government to show that the prices of

1 Vide *Legislative Assembly Debates,* 1941, Vol. IV, pp. 709-36.

the loans happened to be lower at some previous date, unless he can show further that the Government had at that time the wherewithal to finance the purchase. Let us remember in this connection that the prodigious growth of sterling in the vaults of the Reserve Bank of India began only after the outbreak of the war. In September, 1939, the country's resources in sterling were none too plentiful and even assuming that the Government braced themselves overnight to throw tradition to the winds and revalued the gold holdings of the Reserve Bank according to market quotations (as explained below) their resources in sterling at hand would have proved poor enough for the purpose of such large-scale repatriation operation as was carried through in February, 1941.

Let us make this point definite enough. At the end of August, 1939, the total sterling resources of the Reserve Bank amounted to Rs. 66,94 lakhs only, being made up of Rs. 59,50 lakhs held in the Issue Department and Rs. 7,44 lakhs held in the Banking Department. As regards the sterling held in the Issue Department, it is worth noting that much of it is usually earmarked as Currency Reserve and cannot be diverted for any other purpose. Under the Reserve Bank of India Act of 1934, the Bank has to maintain a reserve ratio of 40 per cent. gold and sterling to its total liability for notes issued. At the end of August, 1939, the percentage of gold and sterling to total note issue was 47·94. Though this was somewhat higher than the mini-

mum enjoined by the law, it cannot be regarded as excessive, for a reserve which amounts to not more than the legal minimum is altogether useless in an emergency, as it cannot be drawn upon at all: for to do so would be to push the ratio below the statutory minimum. Its practical utility is, therefore, nil. Hence every prudent banker having to conform to a legal minimum must keep his reserve well above that minimum. Judging from such considerations we would be wise not to set much store by the sterling potential of the Reserve Bank at the outbreak of the war merely because the reserve ratio was somewhat higher than the 40 per cent. minimum. When the legal minimum is 40 per cent., the actual ratio would not be too high even at 50 per cent.

But in this connection there is another factor to be considered. It is that the gold holdings of the Reserve Bank are considerably undervalued, a fact which indicates that the real ratio of the Bank is not the same as the apparent, but is higher. As a matter of fact, the gold in the Issue Department of the Reserve Bank is being valued for a long time now at the statutory rate of Rs. 21-3-10, which is far below the market rate as it has been for much longer than a decade. Even at the outbreak of the war, before gold had entered upon its career of rockety rise, a tola of gold was selling in the Bombay market for Rs. 37-7-2. Since then its rise in value has been hectic. Though it would not be possible, nor advisable either, for the Reserve Bank to re-

value its gold from month to month according to fluctuating quotations in the market, there is much to recommend a revaluation at least in accordance with its pre-war parity.[1] In any case, the very substantial undervaluation of gold held in the Issue Department of the Bank points to a hidden reserve, against which, in time of need, it may be possible to withdraw a considerable volume of sterling locked up ordinarily as Currency Reserve. As gold in the Issue Department of the Bank in August, 1939, amounted to Rs. 44,42 lakhs, a revaluation on pre-war basis would pave the way for a release of sterling valued at nearly Rs. 34 crores. Taking account of sterling in the Banking Department, the total "surplus" sterling of the Bank, thus calculated, at its disposal at the start of the war, may be put down at a little above Rs. 41 crores. The amount would be still insufficient for such a deal of repatriation as was gone through in February, 1941, but certainly it would have made possible a substantial measure of repatriation.

In the following tables calculations have been made showing the maximum amount of sterling which could be spared by the Reserve Bank from its combined resources in both Issue and Banking Departments in each month of the war from August, 1939, to February, 1940. In calculat-

1 In England, the gold in the Issue Department of the Bank of England was revalued sometime ago to bring it in greater harmony with the market value of gold.

ing the surplus sterling it has been assumed (1) that the gold holding of the Bank is revalued at the rate of Rs. 37-7-2 per tola, and (2) that the ratio of gold and sterling in the Issue Department of the Bank to the total note issue is kept 10 per cent. above the legal minimum, that is to say, at 50 per cent. In arriving at the figure for each month, due notice has been taken of the total note issue, the amount of sterling securities held in Issue Department and the amount of sterling balance in the Banking Department, at the end of each month, Only the final results are given, the details being omitted in the interest of simplicity.

THE RESERVE BANK OF INDIA

TABLE I

Last Friday of 1939-40	Surplus Sterling (approximate) Rs. Crores
August	36·00
September	47·00
October	52·00
November	59·00
December	65·00
January	77·00
February	84·00
March	94·00

TABLE II

Last Friday of 1940-41	Surplus Sterling (approximate) Rs. Crores
April	92·00
May	93·00

Last Friday of 1940-41	Surplus Sterling (approximate) Rs. Crores
June	102·00
July	99·00
August	107·00
September	115·00
October	119·00
November	132·00
December	139·00
January	151·00
February	152·00

A review of the prices of the terminable sterling loans from the time of the outbreak of the war up to the date of the first compulsory acquisition shows that they were particularly low in August-November 1939, and were also, in spite of some increase that occurred in them in the meantime, low enough in January, 1940, as compared with the position later on in the year. The January prices were also, generally speaking. considerably less than the prices for which the loans were compulsorily acquired in February, 1941. The pricce curve after January, 1940, was, however, on the upward grade. In fact, between February and May, 1940, nearly all the prices registered a stiff rise. Although they fell back to their officially fixed minimum levels during mid-May-October, 1940, all the prices, but for one unimportant exception. remained on a substantially higher level than that of January preceding. From November, 1940, the prices resumed their upward swing, and they were still

rising when in February, 1941, the Government announced their first scheme of compulsory repatriation. The following tables illustrate the behaviour of the prices as stated above, and the prices for which the Government compulsorily acquired the loans are also thrown into relief.

Prices of Terminable Sterling Loans.

TABLE I

Dates	India 3% 1949-52	India 3½% 1954-59	India 4% 1948-53
Aug. 31 1939	94	95	102
Nov. 30 1939	92¾	94¼	100⅜
Jan. 8 1940	93¾	97	103½
Feb. 7 1940	96¼	101¼	106
March 7 1940	98¼	103	107 13/16
May 13 1940	98¼	102⅜	107¼
June-Oct. 1940	96	100	104
Comp. Acq. Prices, Feb. 8 1941	£99-16-2	£102-16-4	£106-11-7

TABLE II

Date	India 4½% 1950-55	India 4½% 1958-68	India 5% 1942-47
Aug. 31 1939	105½	106½	103½
Nov. 30 1939	103⅜	103½	103¾
Jan. 8 1940	106½	107¾	105¼
Feb. 7 1940	110¾	111½	107½
March 7 1940	111¾	114	106 7/8
May 13 1940	110½	113½	107
June-Oct. 1940	107	109	103½
Comp. Acq. Prices, Feb. 8 1941	£110-1-10	£112-17-0	£104-16-6

Correlating these price changes with the figures for "surplus" sterling as given in the preceding tables, we find that during August-November, 1939, when the prices of the sterling loans were at their lowest, the Government had not enough resources to repatriate them. This precludes us from blaming the Government for not having bought off the loans in the cheapest market. We can, however, legitimately question the wisdom of the Government in not liquidating the loans at other favourable moments when they suffered from no paucity of sterling funds. In January, 1940, for example, the position of the Reserve Bank of India with regard to "surplus" sterling had already changed materially. The surplus sterling in that month was, in fact, already sufficient for the task of liquidating the dated sterling issues of India. A reference to the figures quoted above will show that the prices of the loans in January were also quite low, though not as low as in the hectic months of August-November, 1939. The prices were, moreover, as already stated, considerably lower than those paid for the loans by the Government in February, 1941. Thus the Government of India may be said to have missed in January, 1940, a golden opportunity to pay off the terminable sterling loans of the country. No doubt, to do so, they would have to revalue the gold holding of the Reserve Bank of India in the manner prescribed above, but such revaluation—made only on the basis of pre-war parity of gold and not in accordance with the latest quotations in a war-

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inflated market—would be quite moderate and would leave the position of the currency reserve of the country otherwise quite unaffected. It may be mentioned that even England has, after the outbreak of the war, revalued her gold reserve with a similar object in view.

The next most propitious hour for repatriation struck about the middle of May, 1940. From that time up to the end of October, 1940, the prices of almost all the dated sterling issues of India, reacting to the unfavourable war situation on the Continent and the "Battle for Britain," remained very much depressed and were practically reduced to their officially fixed minimum levels below which, by law, they could not go. The prices during this period were the lowest in the year, except for January. The "surplus sterling" in the vaults of the Reserve Bank during the period was also quite large. It was, in fact, larger than necessary.

But suppose the Government were to refuse in any case—as they actually did—to revalue gold in the manner suggested above? In that case also, as the following table—based on the supposition that (1) gold in the Issue Department of the Reserve Bank of India continues to be valued at the rate of Rs. 21-3-10 per tola but that (2) the percentage of gold and sterling securities to the total note issue is kept 10 per cent higher than the level enjoined by law, that is to say, at 50 per cent—shows, while it would not have been possible for the Government to undertake the repatriation of

the loans in January, 1943, or earlier, they could yet have taken advantage of the not-so-high prices of June-October, 1940, when their 'surplus' sterling even at revised calculations would prove adequate for the purpose. Let us recall in this connection that pursuant to their compulsory repatriation scheme of February, 1941, the Government of India were called upon to liquidate dated sterling stocks of the face value of £73·13 millions only in course of the financial year 1941-42. Of this amount, stocks valued at only £64 millions were dealt with under the British Order and involved cash payment of sterling amounting to £66·3 millions.

"SURPLUS" STERLING

(BASED ON REVISED HYPOTHESES)

TABLE I

Last Friday of	Surplus Sterling (approximate)
1939-40	Rs. Crores
August	2
September	12
October	19
November	25
December	31
January	43
February	50
March	60

TABLE II

Last Friday of	Surplus Sterling (approximate)
1940-41	Rs. Crores
April	58
May	59
June	68
July	65
August	73
September	81
October	85
November	98
December	105
January	115
February	118

Thus we find that the position with regard to "surplus" sterling in each of the months June-October, 1940, was quite comfortable.

Feasibility of Repatriation without payment in sterling. —The above criticism in based upon the assumption that there could have been no question of the repatriation of the sterling loans of India unless the Government of India had already at their command adequate sterling resources in London in a ready form. Proceeding upon this assumption we have shown that there could have been no repatriation earlier than January, 1940, even if the Government agreed to revalue gold on pre-war basis; and no repatriation earlier

than June-October, 1940, if there was to take place no such revaluation.

But may we not impugn this basic assumption itself? Must sterling loans be necessarily repaid in sterling? What if we repay them in rupees? Of course, contractually, the Government of India is or was bound to repay the loans in sterling, that is to say, in terms of the same currency in which they were originally subscribed to. But if the repayment of the sterling loans was as much needed in the interest of India as of Britain—which fairly well describes the position as it actually was—the Government of India might have conceivably induced His Majesty's Government to come to their help by paying the British holders of the loans in sterling from their own account and accepting repayment from them (i.e. the Government of India) in rupees. Such action on the part of His Majesty's Government would have been plausible enough in view of the fact that they actually stood in urgent need of rupees to finance their purchases in India. As we shall see later on, many of the Canadian repatriation schemes pertaining to Canadian sterling issues were carried out in this way. That is to say, as the British Government needed Canadian dollars to pay for their war purchases in Canada, the latter took advantage of this to repatriate her sterling loans in London in exchange for dollars made over by her to the British Government. Could India do the same, her sterling issues could have been repatriated when the market for them was

the best for the purpose, altogether independently of the question whether the Government of India or the Reserve Bank of India had or had not sufficient sterling funds in London.

The Initial Cost of the Loans:—Whatever may be said about the cost of repatriation to India of the terminable sterling loans, nobody regrets that these external liabilities have been abolished, and that they are now, practically speaking, things of the past. To round out this discussion, let us append here a note regarding the initial cost to India of these loans, for all of them had been issued at discount and many of them offered rates of interest extremely favourable to the investors in comparison with prevailing market rates. Some of the loans were quoted at a premium no sooner than the subscription lists had been closed. In the following table statistics are given to indicate the total discount paid at the time of the issue of the loans:

Loan	Year of Issue	Issue Price	Total issue (£ millions)	Total Discount (£)
5% 1942-47	1932 April	95	10	500.000
4½% 1950-55 (1st issue)	1922 October	85	20	3 000.000
4½% (2nd issue)	1923 May	90	20	1 000,000
4½% 1958-68	1928 January	91½	7½	637.500
4% 1948-53	1933 May	97½	12	300.000
3½% 1954-59	1933 November	97	10	300.000
3% 1949-52	1935 July	98	10	200.000

Thus the total discount paid on these loans amounted to £5,937,500. This was almost in exact parity with the total premium paid on liquidation, which amounted to £5.710,000.

CHAPTER IV

From Debtor to Creditor (ii)

Compulsory Repatriation of Non-Terminable Loans—The second scheme of compulsory repatriation was announced in the United Kingdom on the 23rd December, 1941, and in India on the day following. It covered public holdings of the Government of India's 3 per cent. and 2½ per cent. sterling loans. The Order issued by the British Treasury required the British holders to surrender the securities by the 9th February 1942 and payment subject to good delivery was to commence on March 2 following. Holders were offered, including allowance for an interval of about ten weeks from the date of the acquisition to actual repayment date, £90 16s. 1d. for the first loan and £78 2s. 5d. for the second.

The Indian Order was issued under sub-rule (3) of Rule 94 of the Defence of India Rules and was in all essential respects the counterpart of the British Order. The rupee prices of the two stocks were Rs. 1041-10-0 and Rs. 1210-12-0 for the 2½% and 3% loans respectively.

Notice was also given at the same time by the authorities both in Britain and India for the redemption of the 3½ per cent. undated stock—the only remaining direct obligation of the Government of India—on the 5th January,

1943. The Government chose not to utilise their powers of compulsion with respect to this loan on the ground that it was standing so near to par that. combined with the fact that it was redeemable on a year's notice, they "could urge no sufficiently valid reason," in the words of Sir Jeremy Raisman, "for His Majesty's Government to use their special war time powers to acquire it for us. even though the acquisition would have meant some acceleration of the release of sterling for investment in more permanent form in British Defence Loans."

The total outstandings of the 2½ per cent. undated stock on the eve of the war was £11,539,986 and of the 3 per cent. loan was £76,784,185. These figures had been reduced by the time of the acquisition order to £11,046.486 and £70,684,210 respectively, thus showing that more than £5½ millions of these loans had been already repatriated through the earlier schemes of open market purchase and voluntary transfer As regards the 3½ per cent. loans, the total outstandings had been reduced to £78.707,509 at the time of the notice from £88.067,884 on the eve of the war.

Th acquisition prices of the two undated stocks, it may be mentioned, were based on their market prices on the day of the Order.

Of the £88 and odd millions of undated stocks called for redemption under the second scheme of compulsory repatriation, the amount surrendered and paid for by the 31st March, 1942, totalled £73·85 millions made up of £69·86

millions surrendered under the British Order and £3·99 millions surrendered under the Indian Order. The total purchase price amounted to £65·78 millions or Rs. 87·71 crores. The amount paid to London holders was £61·19 millions, and £4·59 millions equivalent to Rs. 4·79 crores was paid out in India. Unlike practice on previous occasions, no rupee counterparts were issued (although there was some deviation from this later on), and "the entire finance was raised in the first instance," as was mentioned by the Finance Member in his Budget speech for 1943-44, "by means of *ad hoc* treasury bills issued in favour of the Reserve Bank." One cause of the non-issue of rupee counterparts to the Indian holders was the fact of the heavy slump in prices of Government of India loans in the local market due to outbreak of war in the Far East. "Exchange at part," as remarked *The Economist,* "would therefore be unfair." It was hoped, however. that the demand for the reinvestment of amounts received in connection with payments made for the acquired loans would give a fillip to the rupee securities.

The Cost of Repatriation—While Government action in liquidating these non-terminable loans of India cannot but receive our whole-hearted approval, we may be permitted to question the appropriateness of the time chosen for the purpose. As it happened, the non-terminable loans were liquidated when their prices were at their highest.

In the following table are given the market prices since August 1939 of the two requisitioned non-terminable loans

and of the third loan about which notice was given. For comparison and contrast, the compulsory acquisition prices of the first two and the redemption price of the third are given at the foot of the table.

Market Prices of Non-terminable Sterling Loans of India.

	India 2½ p.c.	India 3 p.c.	India 3½ p.c.
August 4, 1939	59½	71¼	84
September 29, 1939	56	66¼	79½
December 29, 1939	59¼	71	82⅝
February 7, 1940	66½	78	91
May 13, 1940	69	82	95
December 30, 1940	70½	84	97
June 12, 1941	75½	88½	99⅝
December 22, 1941	78	90½	99
Compulsory Acq. Price	78-2-5	99-16-1	100-0-0

The maximum and the minimum prices of the loans in 1937 and 1938, the two complete years prior to the outbreak of the war, are shown in the following table:—

	1937		1938	
Loans	Highest	Lowest	Highest	Lowest
India 2½ p.c.	72	62	70	55
India 3 p.c.	85¼	74¼	82¾	68
India 3½ p.c.	98¾	87	95⅝	75

The above statistics leave no scope for doubt that the prices at which the non-terminable sterling loans were paid off were the highest prices in the history of the loans in

recent years—and the highest, by all means, since the outbreak of the war.

The Funding of Railway Annuities.—The next important milestone in the repatriation of the sterling debt of India was the funding of the railway annuities amounting to £34,114,654. A *communique* issued on the 30th September, 1942, stated that the Government of India had entered into an agreement with His Majesty's Government, in pursuance of their policy of progressively reducing the sterling debt of India, whereby in return for an immediate lump sum capital payment of £30,054,250, the latter had undertaken to make available to them sums equal to the instalments of the several annuities as and when they fell due so that they might continue to discharge their legal obligations unhampered during the whole currency of the liabilities.

The railway annuities arose out of state purchase of railways in the past, and amounted originally to £81,844,165. They were due to terminate on various dates between 1948 and 1958. The total amount of the annuities was reduced to £60,095,487 by the end of the financial year 1923-24, and under the terms of the Separation Convention of 1924, responsibility for the payment of the annuities was devolved upon the general revenues, while the railway revenues were charged only with interest payable on the capital outstanding.

The effect of the above-mentioned arrangement made with His Majesty's Government was not, as was stated

expressly in the press communique referred to above, to alter in any way "the contractual relationship between the annuitants and the Government of India." but it was merely to ensure that "as a result of them" no provision would require to be made in future from Indian revenues for payments in connection with railway annuites.

Thus liabilities of the Government of India in regard to the railway annuities continue to exist. They have not been extinguished as have been those arising from the dated and undated sterling loans of India. But these liabilities would now sit lightly upon them in view of the fact that as payments to the annuitants fall due in the future, the Government of India will receive from His Majesty's Government, on the strength of the arrangements concluded with them, the necessary sums in sterling for making the actual payments. Thus for the discharge of contractual obligations between the Government of India and the annuitants, a third party, viz. the British Government, has now come into existence to play a vitally important part.

It was claimed by the Government of India that the payment by them to His Majesty's Government of a sum of £30,054,250, to secure discharge, over a period of years stretching up to 1958. of annuities valued at £34,114,654, represented an investment by them at the rate of 2¼ per cent. per annum. This rate claimed for the investment, as we shall see presently, was more apparent than real. Even this apparent rate, however, despite the fact that money

rates in the present war have been low, would be hardly flattering to the Government of India in view of the fact that the latter could have easily secured an equally good or even a slightly better rate if they chose to invest the capital sum, retained under their control but earmarked for identical purpose, in short-dated (terminable) sterling issues. In view of the fact, however, that the Government of India had to reissue, to finance the operation, the 3 per cent. loan 1963-65 for Rs. 15 crores at 95, even this 2¼ per cent rate proved illusory. The total investment was of the order of £30·1 millions equal to slightly above Rs. 40 crores. A loan against this of Rs. 15 crores at 3 per cent. meant that three-eighths of the investment was to carry negative interest at ·75 per cent—even apart from the consideration that the loan was issued at a discount—while five-eights would bring in the full positive rate of 2¼ per cent. The net rate over the entire investment would thus come to only 1·0 per cent. If we add to this the consideration that the 3 per cent scrips issued at 95 would have to be repaid at 100 between 1963 and 1965, the ultimate rate would show off lower still.

The above argument shows clearly the hollowness of the claim of the Government with respect to the rate of interest earned on the investment in question. One must admit, however, that though the mode of the investment was not the best that was open to the Government of India, the object secured under it, viz. provision for due discharge of the railway annuities, was quite commendable.

So far as His Majesty's Government was concerned, the transaction, no doubt, involved the assumption by them of liability for the full interest rate of 2¼ per cent. As even this was somewhat below the current market rate for investment of similar maturity, it was not fully remunerative to the Government of India, but there was compensation for the loss in the fact that the mode of the investment was helpful to the British Government in their war effort.

From the strictly economic point of view, the most profitable course for the Government of India to adopt would be, of course, to deal directly with the annuitants themselves and to persuade them—as it would be easy enough to do, for the annuitants, acting in their own interest would readily accede to the proposition—to accept present values of the capital sums outstanding in their favour. It is also most likely that the annuitants would have, in view of current and prospective market rates, agreed to a discount of 3 per cent. or on the strictest view, of 2¾ per cent. on capital values. In that case, the amount of sterling needed to pay them off would have been substantially less than the £30 and odd millions that was necessary on the basis of discount at the rate of 2¼ per cent only.

Thus direct dealings with the annuitants would have served the economic interests of India better but there would have been no guarantee in that case of the sums paid out to the annuitants flowing to the defence issues of the British Government. Thus we may conclude that while the trans-

action in connection with the railway annuities was not economically the most serviceable one for India, it was the most suitable one to further the war effort of His Majesty's Government.

Repatriation of Sterling Railway Debentures.—Railway debentures outstanding on the 16th January, 1943, when the Government of India announced a scheme to repatriate them, amounted to £31·3 millions. A press communique issued on that date stated that the Government of India had, with the assistance and co-operation of His Majesty's Government, arranged to repatriate the following debenture stocks of the aggregate value of £20 millions at prices noted against each.

Indian Railway Debenture Stocks.

Name of Stocks	Acquisition Price In India		Acquisition Price In the U.K.[1]		
	Rs.	As.	£	s.	d.
(1) E.I. Ry. Irredeemable 4½% Debenture Stock	1,499	2	112	8	8
(2) G.I.P. Ry. Irredeemable 4% Debenture Stock	1,392	0	104	8	0
(3) E.B. Ry. Irredeemable 4% Debenture Stock	1,392	0	104	8	0

1 The acquisition prices in sterling were published in a separate order issued by the British Treasury *Vide Times*, London, for January 16, 1943.

Name of Stocks	Acquisition Price In India Rs. As	Acquisition Price In the U.K. £ s. d.
(4) South Indian Ry. Perpetual 4½% Debenture Stock	1499 2	112 8 8
(5) Burma Rys. 3% Debenture Stock	1,177 14	88 6 10
(6) E.I. Ry. 3% New Debenture Stock	1,234 12[1]	92 12 1[1]
(7) B. & N.W. Ry. 5% Special Debenture Stock	1,371 15	102 17 11
(8) B.N. Ry. Co. Ltd. 4% Debenture Stock	1,361 15	102 2 10
(9) South Indian Ry Co. Ltd. 4% Registered Debenture Stock	1,361 14	102 2 10

Announcement was also made at the same time of the intention to redeem at par the following railway debentures on the 4th February, 1944, *viz.* Bombay, Baroda and Central India Railway 3½% Debenture Stock, the East Indian Railway 3½% Debenture Stock and the Great Indian Peninsular Railway 3½% Debenture Stock. The total amount outstanding against these three issues amounted to £11·1 million. The requisite one year's formal notice to redeem them was given in due course.

1 Ex-interest due on 4th February, 1943.

CHAPTER V

The Technique of the Repatriation Operations.

The technique of the various schemes of repatriation discussed in the preceding chapters may now be restated and some of their special aspects emphasised. As previously stated, all the sterling debts of India have been exclusively paid for in sterling, and no alternative method of repayment has been tried as has been done by Canada.

Every scheme of repatriation of Indian sterling loan has, as has been already mentioned, involved two stages. In the first place, there were the payments in London in sterling and secondly, the provision in India for rupee finance for this sterling.

The payments in sterling were necessary to liquidate the U.K. investors of the Indian sterling loans. In this connection it may be recalled that the Government of India or the Reserve Bank of India never dealt directly with the British investors themselves. In fact, it was hardly within the competence of either authority to do so in an effective manner. For neither the Government of India nor the Reserve Bank of India has ever had any authority to make the British investors surrender their scrips before maturity dates at dictated prices. Every act of repatriation on the part of the Indian Government has presupposed a prior arrangement with His Majesty's Government where-

by the latter, through the exercise of special war-time powers, have got vested in themselves the scrips in question. Payments have been made to the British investors by His Majesty's Government with, of course, money received in advance from the Government of India. So far as any individual British investor has been concerned, therefore, he has surrendered his scrips only at the instance of his own Government, and has received consideration for the compulsory disinvestment also from the same quarter.

If the British investor has got his sterling from the British Government, the latter has got it from the Government of India. But the Government of India having had little sterling of their own, they have got it, again, from the Reserve Bank of India.

The war has made the Reserve Bank brimful of sterling. The fountainhead of their vast incomings of sterling has been already traced to the recurring war purchases of His Majesty's Government, and of also some Allied Governments, in India. How these purchases have given rise to the sterling balances has been already stated. As we have seen, these purchases have been made through the agency of the Government of India who have been made responsible for their rupee finance. The Government of India have secured the necessary rupees from the Reserve Bank of India against their receipts of sterling in London. Thus these war purchases have been financed by inflation of paper currency within India.

The provision in the Reserve Bank of India Act, 1934, placing sterling on a par with gold as reserve against, note issue has stood the Bank in very good stead in enabling it to provide the hundreds of crores of paper currency required by the Government of India for financing their war purchases on behalf of His Majesty's and Allied Governments. Thus the sterling balances which were originally of the Government of India's own, having devolved upon them from His Majesty's Government and other Governments as finance of their agency functions, passed on to the Reserve Bank of India through issue of paper currency against them, and became included in the assets of the Issue Department of the Bank, divested of any property in them by the Government of India.

Every repatriation scheme of the Government of India has seen them sue the Reserve Bank for a part of this sterling, once their own, but now belonging to the latter.

The Reserve Bank has always provided the sum in sterling requested for by the Government of India, but it has, because it cannot for obvious reasons let its assets decline while liabilities continue to be the same, required of the latter substitute or replacement assets of equal value. In the earlier stages of repatriation operations, the Government of India usually issued to the Bank rupee counterparts of the repatriated sterling loans. This served the immediate purpose, but, as we have stated previously, the rupee counterparts, not having a regular market of their own,

were not quite fully eligible as reserve against paper currency. Apart from rupee counterparts, the Government of India sometimes also issued *ad hoc* rupee securities to replace the sterling withdrawn from the Issue Department of the Bank. Latterly, they became more bold and issued three months' treasury bills to the Bank in lieu of sterling. Apart from all these methods it has been, of course, always open to the Government of India to pay the Bank in cash either wholly or in part, for the sterling borrowed from it. A limited use has, in fact, been made of this expedient as well. A part of the rupee finance of the sterling has, thus, come from depletion of cash reserves of the Government of India with the Reserve Bank. The Government have also occasionally taken a ways and means advance from the Bank for the same purpose.

We have already remarked that the Government of India has had usually very little sterling of their own in London to devote to the purpose of repatriation. But whenever they have been able to command surplus sterling in London, that is, sterling over and above their ordinary requirements, they have pressed it to the service of repatriation. Thus sterling receipts in London for recoverable war expenses and war purchases have sometimes been directly utilised for helping repatriation without being encashed in the usual manner in rupees through the Reserve Bank of India.

In this connection it would be both interesting as well

as instructive to study the effect upon the financial position of the Bank of the first scheme of compulsory repatriation of February 8, 1941. Actual payments in connection with the first scheme of repatriation began, it may be remembered, on the 24th March, 1941. Their effect is fully reflected in the statement of the Reserve Bank of India dated the 28th March, 1941. Whereas only a week ago sterling securities held in the Issue Department of the Bank had amounted to Rs. 140,50,11,000 and sterling in the Banking Department to Rs. 78,35,20,000, the figures were reduced to Rs. 102,24,21,000 and Rs. 42,25,28,000 respectively on March 28 following. Thus in a week sterling assets of the Bank fell by Rs. 74,35,82,000. There is no doubt that this amount was involved in cash payments to U.K. investors of the requisitioned sterling loans. Sterling recoveries during the week, of about Rs. 5 crores, were also presumably devoted to the same purpose.

We can also get a clue to the rupee finance of this huge sterling transfer from the same return of the Bank dated the 28th March, 1941. Briefly speaking, the Government had recourse to three stops. In the first place, it issued to the Bank *ad hoc* rupee securities for Rs. 38,25,90,000, the same amount by which its sterling portfolio became poorer in the Issue Department. In the next place, it took a ways and means advance from the Bank for Rs. 16 crores and lastly, it made a draft upon its cash deposits with the Bank for Rs. 22,20,92,000.

Such has been the immediate rupee finance of the repatriation operations. But the problem does not end with the provision for this. We have already seen how a very large part of the rupee finance has been provided for by the issue of rupee counterparts to the Issue Department of the Bank. Such counterparts issued up to the end of the financial year 1942-43 ran up to Rs. 234·97 crores. We need not repeat the arguments showing that the counterparts were undesirable as assets of the Bank. Having issued these counterparts to tide over the present difficulty, the Government of India next set themselves about converting them into existing loans having a regular market. They were successful, as we have seen, to wipe off the 4½ per cent rupee counterparts in this way. Another counterpart, viz., the 5 per cent 1942-47, was more drastically treated, being paid off at the first opportune moment, viz., June, 1942, cash down. This step was in a sense exceedingly significant. The liquidation of the sterling loan, 1942-47, against the the issue of a rupee counterpart implied that the loan was not in the last analysis extinguished, but was merely converted into an Indian loan, that is to say, repatriated. It was the extinction of the rupee counterpart which really proclaimed the final disappearance of the loan.

To the extent that the Government of India issued Treasury Bills to the Issue Department of the Reserve Bank of India to finance repatriation, the problem that confronted them was to fund this floating debt into a more perma-

nent form. This has been done by the application of the proceeds of the defence issues for the retirement of the Treasury Bills. The success of the Government of India in this respect has been of a high order. While the Treasury Bill outstandings of the Government of India on the 1st March 1941, when the repatriation operations had not begun, amounted to Rs. 68,90,25,000, the same on the 6th April, 1944, stood at Rs. 76,06,50,000. Between these two dates the total sterling loan repatriated by the Government of India amounted to nearly £300 millions (Rs. 400 crores), but the floating debt of India increased by less than Rs. 10 crores.

Repatriation vs. Redemption.—Repatriation of a sterling loan means its conversion from a sterling debt repayable in sterling in London into a rupee debt payable in India in rupees. India has got rid of her loans expressed in sterling. But she has incurred to a corresponding extent indebtedness in rupees. Secondly, whereas the holders of her sterling loans were mostly foreigners, the holders of the rupee counterparts or corresponding rupee loans have been mostly Indians. In none of her compulsory schemes of repatriation has India granted an option to the U.K. holders of sterling loans to have their scrips exchanged into rupee counterparts. The U.K. holders have been paid off outright. Of course, when the Government of India introduced their licence scheme of February, 1940, an option was given to the U.K. holders of the Indian sterling loans to get

their scrips converted into rupee counterparts and to have them registered in India. As we have seen, very little advantage was taken by the latter of this offer. In subsequent schemes of repatriation, the U.K. holders had no option but to accept payment in cash. Thus India has not only liquidated her sterling debts, but has now very few external creditors to make any call upon her.

Some Indian rupee loans are, no doubt, daily traded in in the London Stock Exchange, but their amount is not great enough to be of much significance.

This constitutes a salient point of difference between Indian repatriation and repatriation by Egypt. As we shall see more fully later on, Egyptian repatriation of sterling debt has proceeded on the basis of converting Egyptian sterling loans into internal loans, and foreign holders have been given in almost all cases full facility to get their sterling scrips converted into Egyptian internal loans. There has been thus no disinvestment of the U.K. holders in the manner in which the U.K. holders of the Indian sterling loans have been disinvested. There has been disinvestment of the U.K. holders of Egyptian sterling loans only to the extent that the rate of interest offered for the Egyptian internal substitute loans may have been lower than the rate enjoined for the repatriated sterling loans.

The Economic Effects of Repatriation.—The economic effects of the repatriation of the sterling loans may now be briefly stated. Repatriation of sterling loans has been help-

ful to some extent in countering the raging inflation of currency within the country. In the last analysis repatriation has been financed by the proceeds of the defence issues. Thus several hundred crores of rupees have been absorbed from the money market which would have otherwise pressed upon the dwindling supply of consumption goods and driven their prices to even higher altitudes.

India's sterling balances in London are usually invested in short-dated securities earning a rate of interest of something like ½ to ¾ per cent. The appropriation of such balances yielding a very low return for liquidation of loans carrying interest at not less than 2½ and up to 5 per cent per annum is obviously of great economic advantage. The bulk of the rupee counterparts issued against the repatriated sterling loans have been in the first instance held by the Government of India and the Reserve Bank of India. To the extent that they have been held by the former, the entire interest payment has been, of course, saved; to the extent that they have been held by the latter authority, their profits have swollen and larger profits of the Bank directly benefit the Government because they are entitled, under the statute, to a share of these profits. In so far as the counterparts have been held by the public, there has been advantage to the Government from the fact that they have been enabled to deduct income-tax on these counterparts at source.

The non-terminable sterling loans were repatriated

against the issue of Treasury Bills. Till the Treasury Bills were funded, the saving of interest secured by the Government of India was represented by the difference between the rate of interest on the repatriated loans and the rate on the Treasury Bills. The rates of interest of the three non-terminable loans were 2½%, 3% and 3½% respectively while the average rate paid on treasury bills in 1942 and 1943 has been exceedingly small, something like ½ per cent. Thus we see that the saving of interest has been quite substantial. The treasury bills have been, however, gradually replaced by more permanent loans, which have been generally floated at 3 per cent. Other rupee counterparts have also been converted into loans carrying lower rates of interest. The 5% rupee counterpart has been straightway paid off. Thus we may conclude that while the repatriation of the sterling loans of India may not have signified a net decrease in the amount of the public debt of the country, it has meant the substitution of debt carrying lower net rate of interest for debt carrying higher rate of interest. In this connection we should remember the fact that most of the Indian sterling loans were issued at heavy discount so that the rates of interest pertaining to them, while high in themselves, were actually much higher.

The repatriation of the sterling loans, by reducing the sterling balances of India in London, have made it easier for the remaining balances to earn higher rates of interest in the London discount market. Moreover, the accumu-

lation of foreign balances, beyond a certain point, is undesirable and repatriation has helped considerably in easing the problem of surplus sterling balances of India in London.

Repatriation of sterling loans has reduced to insignificance the interest payable by India in sterling in London. Whereas the interest charge on sterling debt in 1938-39, the last complete pre-war year, amounted to £13,000,000, it is estimated that at the end of 1943-44 it fell to about £2,750,000. The elimination of the sterling interest charge is of great importance to the country. The problem of transfer takes at times an acute shape and upsets the budget. The reduction of foreign obligations has also reduced the need for holding cash balances in London. The cumulative effect of all these factors is no doubt of great importance.

Last, but not of the least importance, is the fact that the repatriation of the sterling loans has revolutionised the status of India in the international money market. India is now a creditor nation, no longer the debtor she has been ever since she established trading relations with Britain. The residue of sterling loans still unpaid—simply because they have proved to be inaccessible—is too insignificant beside our vast sterling balances in London. India can pay off the balance of her sterling debt to Great Britain with hundred times greater facility than that with which Britain can return to us our sterling in London. Thus Great Britain emerges out of this war as a debtor to India and India as a creditor to Great Britain.

CHAPTER VI

Repatriation by Empire Countries.

More or less the same extraordinary circumstances that have given rise to the phenomenon in London of the huge ready sterling balances of India have created similar, though not exactly equal, resources in London in favour of other empire countries and also some non-empire countries. These circumstances, to repeat, have arisen mainly from Britain's war expenditure in these countries.

These sterling funds represent Britain's indebtedness to the outside countries. Britain can look upon them with mixed feelings: Feelings of satisfaction at the manner of their coming into existence and of concern at their somewhat sinister significance for her in the future. These sterling funds are the result of the fact that Britain has been permitted by the empire countries to make her war purchases in them without offering them in return any *quid pro quo* in the shape of producers', or consumers' goods, or, for the matter of that, any other goods, and to place at the disposal of her creditors her currency, sterling, which merely signifies an amount of purchasing power which, again, at least for the duration of the war, is practically unusuable except for very limited purposes. To the extent that Great Britain has enjoyed this facility she has

been left free to exploit her productive resources exclusively for her own advantage in the war, and has not been called upon to divert any portion of these for the purpose of supplying foreign markets in return for her own supplies from them. This has also saved her from the necessity of solving many a knotty problem of exchange and from a depreciation in the external value of her currency that would otherwise have taken place. There is no doubt that sterling, which the impact of the war has already greatly diminished in value, would have fallen even more heavily if Britain had been called upon to pay her foreign creditors in their own currencies or in gold. The weakness of sterling arises also from the fact that so long as Britain's peace-time export industries remain geared to war production, there can be no effective demand for sterling from the rest of the world. In such a conjuncture, the action of the empire countries in not making any immediate use of any portion of their sterling resources has had the effect of a loan made by them of this sterling to Great Britain, and this has saved sterling from finding its true level much downwards.

As already referred to, these sterling funds also constitute a potential danger to British post-war economy. These funds, it should be remembered, are in Britain on the current account of the various countries owning them, and are liable to be withdrawn by them on demand. So long as the war continues, they are, of course, likely to remain where they are alike on account of the eagerness of

the creditors to spare Great Britain any avoidable financial embarrassment as on account of the practical difficulties of transferring such huge resources in war-time from one country to another over the multifarious barriers of exchange control. But after the war, conditions are bound to be different, although it is far from likely that it will be possible to abrogate exchange control all at once. In the absence of international agreement (to secure which efforts are already under way), each creditor country will have full freedom after the war to dispose of its sterling balances in the manner it might consider most appropriate to its self-interest. If all the countries want to withdraw their sterling balances all at once, or within a very short period—which at least is a theoretical possibility—problems similar to those which bedevilled reparations payment by Germany at the end of the last great war will raise their heads again, and will result either in economic chichanery or moratorium or downright repudiation or writing-off.

These war-time foreign balances constitute therefore an important financial and political problem. Repatriation of sterling loans by India and Empire countries has done something to make this problem somewhat easier from a world point of view though, so far as Great Britain herself has been concerned, repatriation—inspite of its immediate utility to her in the manner already stated (e.g. helping defence issues) and utility in lessening her external idebtedness—has been useful as a painful surgical operation, for,

from the long point of view, repatriation has been to her another name for disinvestment.

We have already considered repatriation of her sterling loans by India. But India is not the only country to have embarked upon repatriation—though she can claim the distinction of being the first country to do so. Indian repatriation, it may be recalled, started as early as 1937-38 whereas Canada, the first Dominion to announce a big scheme of repatriation, took a hand in the matter only in October 1939. India also has had the distinction of being the first empire country to undertake compulsory repatriation, i.e. repatriation of sterling loans earlier than their first optional dates of redemption. Though some Canadian dollar and sterling securities were recalled and compulsorily repaid in October 1940, that is, even earlier than the first Indian scheme of compulsory repatriation announced in February 1941, compulsion was used in that case, as we shall see later on, not at the instance of the Canadian Government, but by the British Government in their own interest for securing Canadian dollars.

A brief account is given below of repatriation operations that have taken place in some other countries, and as the technique of repatriation in these countries has in some important details differed from that adopted in India, the present study may be useful as throwing into bolder relief some of the features of the transactions carried out in this country.

Repatriation of Sterling Loans by Canada.—Canadian repatriation is distinguished from that of any other country by the fact that it has been effected in substantial amounts without Canada paying British holders in sterling. Canada has liquidated many of her big sterling issues in exchange for her own currency, the Canadian dollar. Thus she has demonstrated the fact that repatriation of sterling loans need not necessarily wait upon the debtor country possessing sufficient disposable sterling funds in London, but may take place on fundamentally different terms altogether. Be it mentioned also that the Government of the Dominion of Canada was no suitor to the British Government for permission to pay dollar for her sterling loans; the position, if anything, was the reverse. The British Government have not had the same facility to which they helped themselves in their purchases in India, of paying for their Canadian purchases of war supplies in their (i.e. the purchaser's) own currency, sterling. No doubt they have had this facility, but not to the same extent as in India. Many of the British purchases in Canada have had to be paid for in Canadian dollars. British exports to Canada during the war being choked off by war conditions, Britain's current resources of Canadian dollars have been greatly restricted, and it is the anxiety of Great Britain to secure Canadian dollars adequately for her purpose that has forced her hands to relinquish her assets of Canadian loans as a price for Canadian dollars.

The first Canadian loans to be repatriated after the outbreak of the war was her largest sterling loan, *viz*. the 3½ per cent. stock 1930-55, £28,162,776 of which was outstanding at the date of the order for redemption. This took place in October, 1939, when the British Treasury issued an order for the declaration by the residents of the United Kingdom of their holdings of the stock, which were instantly vested in the Government. As the loan was already optionally repayable, holders were paid off at par, plus accrued interest, and received £100 13s. 5d. for £100 nominal. The payments in the first instance were made by the British Treasury, and repayment on the part of Canada took place on 17th April, 1940.

To finance the repatriation, the Canadian Government issued to the Canadian chartered banks $200,000,000 of two-year 2 per cent Canadian Treasury notes at par. The bulk of the proceeds was utilised to repay the £28,000,000 of the 3½% sterling stock called for redemption, and the balance was devoted to the repayment of three domestic issues totalling $28,000,000. Thus, as a result of this repatriation operation, the British Government came to secure Canadian dollars of the total value of £28,000,000.

Thus while Indian repatriation of sterling loans has been mainly motivated by the anxiety of the Government of India to get rid of their external indebtedness and also their anxiety to reduce the volume of their ever-mounting balances of ready sterling in London, Canadian repatriation,

in the instance stated above, proceeded primarily from the anxiety of the British Government to secure Canadian dollars in order to be able to pay for their purchases in Canada of primary commodities and manufactures required for the efficient prosecution of the war. It was, as the *Times* of London remarked, "a co-operative move of which the importance needs no emphasis."

The next Canadian sterling loan called in for redemption was the 4% stock 1940-60. An Order was issued by the British Treasury in June, 1940, requiring British holders of the loan to make returns of their holdings to the Bank of England by the 29th June, 1940. The stock of which £19,300,000 was outstanding was taken over by the British Treasury at the price of £100 12s. 6d. per £100 nominal, and repayment to the holders began on July 1st following. Repayment by Canada was made on 1st October, 1940.

The object of this scheme of repatriation was the same as that of the preceding one—*viz*. supplying the need of the British Government for Canadian dollars. Thus repayment was again made by Canada in her own currency and not in sterling.

The same impelling necessity on the part of the British Government for dollar hastened the third scheme of repatriation which was announced only a few days after the last was heard of the second scheme. The third scheme was, in a sense, unique. being distinguished from the first two in one important respect,—*viz*. that Canada now repatriat-

ed, mainly, not her sterling loans, but her dollar loans held in British hands. There is no Indian parallel to this—for in this country we have not even thought of liquidating rupee loans in non-Indian hands in London.

The third scheme was announced on October 26, 1940 when the British Treasury issued a vesting Order whereby about sixty issues of Canadian railway and other Canadian companies payable solely or optionally in Canadian dollars were taken over along with a few sterling issues including one large issue, viz., the Grand Trunk Perpetual 4% consolidated stock.

This scheme of repatriation was thus a disinvestment by the British people of their real and tangible assets in Canada and was comparable to their disinvestment of U.S. dollar securities twice previously, caused by similarly impelling necessity for U.S. dollars. Of Canadian dollar securities, this was, however, the first enforced relinquishment. As was explained in an official note issued on the occasion, this scheme of repatriation was in pursuance of arrangements made with Canada by the British Government at the outbreak of the war to make it possible for the latter to obtain Canadian dollars through repatriation by the Canadian Government of Canadian securities owned by residents in Britain.

Another point of importance and interest in connection with this particular scheme of repatriation is that the Canadian dollar securities acquired by the British Government

by means of the vesting order referred to above were not made over to the Canadian Government, but were disposed of direct to the investors in the Canadian market—the rate, scale and the time of disposal depending as much upon "the need for orderly marketing" as upon "the desire to obtain substantial amounts of Canadian dollars to meet United Kingdom expenditures in the Dominion."[1] It may be mentioned in this connection that U.S. dollar securities previously acquired compulsorily by the British Treasury had also been disposed of to the U.S. investors direct on the Wall Street, and had not been sold to the U.S. Government.

British holders. who were paid in sterling by the British Government, were accorded permission, subject to certain conditions, to subscribe the whole or a part of the sums received by them to 2½% National War Bonds and 3% Defence Bonds.

As already stated, this repatriation operation also involved some sterling securities. The names of the securities concerned and the prices for which they were acquired are given below:

CANADIAN STERLING SECURITIES

	Price per £100 Nominal		
	£	s.	d.
1. Canadian National Railway, successor by amalgamation to the Grand Trunk Pacific Railway Co., 4% sterling bonds, 1926 ...	117	14	2

1 *Vide Times*, October 28, 1940.

	Price per £ 100 Nominal		
	£	s.	d.
2. Do 3% First Mortgage Sterling Gold Bonds, 1962	107	5	8
3. Porto Rico Power 5% Refunding General Mortgage Bonds, 1962 (sterling bonds)	109	11	9

Of the above, the G.T. 4% consolidated debenture stock had about £24,600,000 outstanding against it. The total sum involved in the entire operation was estimated at about £50,000,000

Compulsory Repatriation upon Indian Model.—Canada's next scheme of repatriation, based upon the Indian model, had not as its primary objective the making of Canadian dollars available to the British Government—the "lease-lend" facilities accorded to Great Britain by the U.S.A. through the instrumentality of the Lease and Lend Act passed in March, 1941 had already placed the former country in a strong position regarding war supplies and had lessened its urgency for Canadian dollars—but it had the main objective, as of the Indian schemes, of reducing her growing sterling balances in London.

The scheme was announced in August, 1941. About the middle of the month the British Government issued an Order, under the Securities (Restrictions and Returns) (No. 2) Order, 1941, requiring of the owners of the following Canadian securities to surrender their holdings to the Bank of England. The scrips would be taken over by the Treasury from the Bank. The holders were to be paid on terms specified below.

CANADIAN STERLING LOANS

			Acquisition Price per £100 Nominal. £	s.	d.
1.	Government of Canada 4% Registered Stock 1953-58	£15,000,000	110	12	11
2.	Govt. of Dominion of Canada 3¼% Regd. Stock 1950-55	£10,000,000	104	2	5
3.	Govt. of Dominion of Canada 3¼% Regd. Stock 1958-63	£10,000,000	104	2	5
4.	Govt. of the Province of Ontario 4½% Regd. Stock 1945-1965.	£151,170	105	7	6
5.	Govt. of the Province of Ontario 4½ Regd. Stock, 1947	£316,713	105	2	6

It will be noticed that none of the loans had arrived at the stage where they could be even optionally repaid. Canada thus chose like India to pay off sterling loans which were not yet mature for redemption. Her object was to reduce her external debt and also her foreign balance in sterling. Hence she paid off British holders out of her accumulating sterling balances in London. She based the acquisition prices, noted above, upon market prices *plus* compensation for the delay in making the actual payment. As she was using compulsion, and taking advantage of her special war-time powers to force liquidity upon the British holders in disregard of the letter of the contract, it was not possible for her, of course, to pay off the loans at par.

The use of compulsion by Canada for reducing her indebtedness to Great Britain provoked some amount of

adverse criticism in London circles. The earlier compulsory liquidation of Canadian securities in October, 1940 had a different footing altogether. The British Government which needed Canadian dollars had helped itself on that occasion to private possessions of its own nationals of a large number of Canadian dollar and some sterling securities—not, of course, without consideration. That was compulsion used against British subjects by their own Government—a perfectly legitimate procedure in a war. But in the present instance the Canadian Government was definitely out to reduce their debtor position. Though even such action on their part was calculated to help the war effort of the British Government in various ways and to lessen their own liabilities to foreign countries, from the point of view of the individual British investor it meant forced substitution of less remunerative for more remunerative investment. The voice of the London money market was echoed in the following comment of *The Economist*[1] made in connection with the above transaction: "It is incontestable that, in war-time, every investor holds his securities—or, for that matter, his business interest, and his assets generally—at the disposal of the authorities for the successful prosecution of the war. Under the relevant Defence (Finance) Regulation, the authorities can take over securities if they are 'of the opinion' that calling up is

1 Vide *The Economist* for August 23, 1941.

'expedient......for the purpose of strengthening the position of the United Kingdom.' The question arises, however, whether the compulsory repayment of securities which, under the terms of the bond on which the money was originally subscribed, have a definite and somewhat distant range of repayment dates, is a precedent which ought to be widely followed. The process of imposing involuntary and premature liquidity on holders who may have arranged their portfolios on a time-table determined by their own contractual obligations (from which *they* have no power of release) will obviously involve a good deal of hardship if carried to a point at which no holder of a dated sterling stock can feel sure that he will not be a holder of cash tomorrow."

The Economist for August 28, 1943, published the following summary of Canadian repatriation of external loans in the whole of the 'sterling area.'

A. Repatriation by Canada of Securities in Sterling Area.

Calendar Years	In Millions of Canadian Dollars. Amount
1939	75
1940	137
1941	189
1942	296
Fiscal Year	
1942-43	73

B. Private Capital Payments by Canada (Including Repatriation) during the War.

Calendar Years	In Millions of Canadian Dollars.
1939	105
1940	111
1941	73
1942	51
Fiscal Year	
1942-43	48

Commenting upon these figures the journal points out that over the four calendar years 1939-1942 Canada ran up credits with the sterling area for $2,650 millions and of this. repatriation of overseas debt in the sterling area could liquidate only $1.310, i.e. 50 per cent. The balance of $1,340 held by Canada in London on current account stands in the same position and gives rise to the same problems as India's ever growing sterling balances in London.

A feature of a portion of Canada's sterling accumulations and sterling credits in London is that they have been quite unconnected with the war purchases of Britain in that country. Canada has come to the assistance of the mother country in the war by offering her in some cases various interest-free loans and sometimes even gratuitous contributions. It may be recalled in this connection that India donated £100 millions to Great Britain in the last Great War. The following table sets forth interest-free loans and other contributions made by Canada to Great Britain during this war.

Interest-free Loans and Contributions by Canada to the United Kingdom.

Calendar Years	In Millions of Canadian Dollars.
1939	—
1940	—
1941	—
1942	1,700
Fiscal Year	
1942-43	1,700

Repatriation of Sterling Debt by South Africa.—South Africa is another important empire country which has availed itself of the extraordinary opportunities created by the war to liquidate nearly the whole of its external debt—meaning, thereby, sterling debt.

The total sterling debt of South Africa at the outbreak of the war exceeded £100 millions. Like India and Canada her first choice for redemption fell upon those sterling loans which had become already optionally repayable. Later on, to expedite the reduction of external indebtedness she followed in the foot-steps of India and Canada. and had recourse to the method of compulsion.

South Africa has paid off her sterling debt mainly out of her accumulating current resources in London. In some cases, however, she has floated a special internal loan to finance repatriation. About South African sterling loan and South African sterling resources in London, there is one special point that calls for notice. It is that most South

African sterling debt is, or was, repayable at the option of the debtor Government either in gold or in sterling. Gold. it may be mentioned, is a staple product of South Africa and also one of her chief articles of export. In the next place, South Africa has always preferred to hold her sterling in London almost wholly in terms of gold. These special factors give South African repatriation a somewhat dissimilar significance to that attaching, say, to repatriation effected by India.

The first South African repatriation of sterling loans took place on the 1st July, 1940, when the Union Government announced her decision to exercise her option to redeem at par her 5% sterling stock. 1940-60. This operation, as already stated, involved no breach of contract, for the loan had become already repayable at the option of the debtor government. The balance of the stock outstanding at the date of the order was quite small, being only £7,900,000 and South Africa had little difficulty in paying off the entire amount out of her growing sterling resources in London.

In December. 1942, the British Treasury announced a fresh scheme of repatriation of South African sterling debt. The scheme involved £40 millions out of £50 millions of South Africa's sterling debt then outstanding. In accordance with this scheme, the British Treasury issued a vesting order requisitioning the following loans of the South African Government at prices noted against each:—(1) Union of

South Africa 5% 1950-70 Loan at £112. 4s. 1d; (2) 4½% 1955-75 Loan at £112. 9s. 1d; (3) 3½% 1953-73 Loan at £103 3s. 4d; (4) 3½% 1955-65 Loan at £103 3s. 4d. and (5) 3% 1954-64 Loan at £100 8s. 1d. The requisition prices were based on the Stock Exchange's closing prices as on 18th December, 1942, including allowance for interest during the interval between the dates of call-up and repayment. It was announced that repayment would be made on the 15th February, 1943.

This repatriation operation was distinguished from the previous one by the fact that it involved redemption of loans which had not yet become repayable by contract. Thus liquidity was thrust upon the holders prematurely. South Africa followed in this regard the example set by India almost exactly a year ago, and naturally there was some amount of feeling over her action in the London market.

Another feature of the repatriation operation was that the loans which were repatriated had to be paid for in gold, "thus demonstrating," as the *Capital* wrote, "the confidence the British Treasury maintains in this commodity."[1]

After the operation of the 15th February, 1943, only two South African loans remained on the market. They were (a) the Transvaal Guaranteed 3% stock 1958 and the Union 3½% inscribed stock 1954-59 each for £5 millions.

1 Vide *Capital*, Feb. 11, 1943, p. 168.

Repatriation of Sterling Debt by Egypt—Egypt entered late in the repatriation race, that is to say, only about the last quarter of 1943. Her total sterling debt at the outbreak of the present war was nearly £90 millions. This was divided among six scrips, three of which, viz., the 3% Guaranteed, 4% Unified and the 3½ Preference Stocks, were direct issues of the Egyptian Government. The fourth loan, the 4% stock of the City of Alexandria, carried the guarantee of the Egyptian Government. The remaining two loans, viz., the 4% and 3½% Ottoman loans, were originally secured on the Egyptian Tribute, but were now the sole responsibility of the Egyptian Government itself. Of £90 millions involved in the six loans, £55¼ millions was held in the Unified and £29½ millions in the Preference Stocks.

A special point about these Egyptian loans is that they were all mature for repayment. They were either repayable at any time at the option of the Government, or at stated dates annually. Thus Egypt had not to commit a breach of contract, in however technical a sense, for extinguishing her sterling debt, as had to be done by India, Canada and others.

Another distinguishing feature of the Egyptian redemption was that it connoted, in the main, not the paying off of external creditors as such, but merely the conversion of debt payable in external currency into debt payable in internal, that is to say, Egyptian currency, External holders of the two major Egyptian loans, viz., the

Unified and the Preference stocks were given the option, specifically, to get their sterling scrips converted into Egyptian internal loans. As compared with this, the Indian repatriation has been fundamentally different. It may be recalled that when in February, 1940, the Government of India announced their first major scheme of repatriation, on the basis of voluntary transfer of scrips from London to Indian register, an option was in fact given to British investors, of which, however, very little advantage was taken by them, to get their sterling loans converted into rupee counterparts. The option was not repeated in any subsequent scheme of compulsory repatriation. Rupee counterparts were, no doubt, issued in many cases, but these were not offered for the acceptance of the holders in London. Thus, India has not only liquidated her debt in external currency, but has concentrated nearly all her debt in the hands of Indian residents. Egypt has, in a sense, paid off her external debt more in name than in fact. By abolishing her liability to remit interest and principal in foreign currency, she has no doubt eased down her problem of transfer, but the continuance as before of outsiders as creditors is in itself undesirable, both on economic and political grounds, and this constitutes the principal flaw in her act of repatriation.

Repatriation by other Countries.—Of other countries which have repatriated their sterling loans during the war, mention may be made of Argentina, Australia, and New Zealand.

(a) As as been already stated, the sterling balances of Argentina stand upon a special footing, being protected by a Gold Clause. The clause does not, however, make them immediately convertible into gold, but protects them from a hypothetical depreciation of sterling in terms of gold. For the present, the balances remain in a special blocked account. They are, of course, available for the repatriation of Argentina's sterling debt, and use has already been made of them for this purpose to a considerable extent.

According to the Annual Report of the Banco Central for 1942, sterling equivalent of 295 million pesos had been accumulated by Argentina in her blocked account up to the end of the year. This accumulation, states the Report, would have been still greater but for the repatriation by Argentina of her public and private debt in sterling amounting to 123 million pesos.[1]

According to an official report issued in Buenos Ayres on September 16, 1943, the sterling balances of Argentina in Banco Central's special account in London amounted on that date to £42,800,000. The same *communiqué* also announced a scheme of repatriation amounting to £16,000,000 by the end of 1943 and £9,000,000 in February, 1944.[2]

(b) Australia has already paid off her war-time indebtedness in sterling. The total overseas war indebtedness of Australia up to the 30th June, 1943, amounted to

1 *Vide The Economist* for June 12, 1943.

2 *Vide Ibid., November* 13, 1943.

£ (Australian) 175,000,000. The last instalment of this debt to be paid off amounted to £12,000,000 advanced by the British Treasury in 1940. The repayment was made in November, 1943.

Australia's sterling balances at the beginning of the war were at a low level. By August 1943, however, they rose to £ (Aus.) 83,000,000. The chief factors contributing to the increase were the payments by the British Government for Australian wool and the credits resulting from the dollar payments by the United States troops.[1]

With the elimination of her war-time special debt, Australia now looks forward to repatriating or liquidating her publicly held sterling loans. She has already repaid in January last her 3½% sterling stock, the outstanding amount of which was £4,491,000. Another 3% issue falls due on 1st October, 1944 and it involves a sum £8,125,000.

(c) Another country to which the war in its earlier stages bought sterling indebtedness and not sterling accumulation is New Zealand. Up to the end of 1942, she borrowed from England, on an overdraft basis, a total sum of £20,221,000. Mr. Fraser, the New Zealand Prime Minister, making an announcement in June, 1943, stated that of this amount, a sum of £19,423,000 had been already repaid, leaving only £798,000 outstanding.

1 *Vide Capital,* November 11, 1943.

CHAPTER VII

THE FUTURE OF INDIA'S STERLING ASSETS

While the repatriation of the sterling loans of India has no doubt helped considerably in reducing the size of our current balances in London, it has far from provided a complete solution of the acute problem presented by them. Repatriation has absorbed only about £350 millions of our sterling funds, while our gross accumulations of sterling have exceeded £1500 millions. Even after appropriations for the purpose of repatriation and for the current needs of the Secretary of State for India and the High Commissioner for India, our net balances of sterling in Great Britain approximate at present to £1,000 millions. Moreover, our sterling accumulations still continue to grow. Hardly a week passes without there taking place in them a fair amount of increase.

The accumulation of sterling resources during this war has been no isolated phenomenon peculiar to India alone. All empire countries have come by large sterling funds in the course of the war, and the same underlying cause has prevailed everywhere, *viz.*, war purchases of His Majesty's Government. In the case of India, however, there has been another potent factor, *viz.*, our recoverable war expenses in terms of the Financial Settlement of 1939.

The following table gives us an idea of the growth of the sterling funds of India and some other empire countries:

STERLING FUNDS OF EMPIRE COUNTRIES.

(In millions of pounds)

Country	Date	Total Funds	Date	Total Funds
India	19th Dec. 1942	210	July 16, 1943	500
Eire	September, 1941	81	March, 1943	121·5
Canada	Oct. 31st 1942	147	August, 1943	157·3
Egypt	...	...	December, 1942	71·2
Malay	July 1941	60	July, 1941	58
Australia	September 1941	42	May 31, 1943	64
New Zealand	July 1941	27	February, 1943	34

Thus, while almost every country has improved its position with regard to sterling, India has done so by leaps and bounds. Since July, 1943, when India's sterling balances in London amounted to £500 millions, there has taken place up to the time of writing (July, 1944) almost a hundred per cent increase in the funds. One reason undoubtedly is that with the liquidation of our sterling debt one brake upon the net growth of sterling now operates no more.

The size of the sterling funds of India has led many to stigmatise them as abnormal. This word first appeared with official sanction, with reference to wartime accumulation of foreign balances, in the United States proposals for "A United and Associated Nations Stabilisation fund." Since then, it has been quite in the fashion to call them so.

It must be stated, however, that the size of the funds in itself does not warrant such a description. India's sterling funds are no doubt very large; in fact. regarded as demand liabilities of Great Britain to India, they are, from the British point of view, rather inconveniently large; but that is hardly any reason why they should be given a bad name. These sterling funds are the financial counterpart of the physical suffering of the Indian people during war—suffering caused by various privations such as want of food and clothing, restrictions on travel. and so forth. These privations have resulted from the fact of an ever-growing purchasing power pressing upon a dwindling civilian supply of essential commodities. Thus India's sterling balances have been dearly bought. The word 'abnormal,' in itself more or less harmless, yet conveys in the popular mind an implication of profiteering; and hence its use in the present context is inappropriate.

What are we to do with our surplus sterling in London? That is the question vexing today every Indian politician and patriot as well as the British public man, economist and official spokesman. Before we proceed to a consideration of the various suggestions that have been made in this respect. let us say a few words about the nature or status of our present sterling resources in Great Britain. This nature or status which we are about to describe has been only gradually revealed to us. When India first began accumulating her sterling balances in London, no body

questioned that these represented so much ready purchasing power which we were free to use in any manner we liked, subject, of course, to war-time exchange restrictions. These restrictions were, moreover, popularly understood to be temporary and intended for the duration of the war. But as, week after week, the sterling funds shot up to higher and higher figures, doubt began to be expressed from British official quarters regarding India's freedom to use them as money on current account. In the course of a very frank statement made in the Indian Legislative Assembly on the 5th March. 1943, Sir Jeremey Raisman roundly described the sterling accumulations of India as a 'debt,' 'a postponed claim for goods and services.' "After all," he said, "the sterling balances represent a postponed claim for goods and services to be rendered at a time when they can be made available. and it must be in relation to the world as it will be after the war, when the circumstances can be more clearly defined." "But I would like to remind the House," continued Sir Jeremy Raisman, "of the precise manner in which the sterling balances arise. I find that there is a general feeling that goods are exported out of the country or services are possibly rendered in other theatres of war and that this is the only way or the main way in which the sterling balances arise. but I must remind the House that, in so far as the whole cost of defence of India on Indian soil is not borne by India, the debt which Britain is incurring to India arises; in other words, if the cost of the

measures being taken in India for the defence of India is borne only half by India, then the other half is owed by Britain to India and becomes a sterling credit which forms part of the sterling balances. Now, that is a very pertinent matter to be borne in mind. This is not of the nature of an ordinary commercial debt which arises when goods are supplied by one party and goods are due in exchange from the other."[1]

Thus by tendentious argument Sir Jeremy Raisman has reduced our current resources in sterling to the status of a 'debt'. Now, our sterling balances in London can be called a debt only in a very loose way. A debt implies a right to something, which is not in the present possession of the creditor and may not also be, at a given moment, in the possession of the debtor. Thus when B owes me Rs. 100, the money is not in my hands, nor may it be just now in the hands of B. But the case with regard to our sterling balances in London is different. The sterling is actually in our possession through the London office of the Reserve Bank of India. It is absolutely indistinguishable from any other sum in sterling in the hands of any other person or corporation in the United Kingdom. It is also available for direct consumption within the United Kingdom. We cannot be prevented from expending it in that country unless by persuasion. It is not something which Britain has to give us, but something which we already have.

1 *Vide Legislation Assembly Debates* for 1943, Vol. I. p. 806.

For practical purposes, however, our sterling balances do partake of the nature of a debt. We do not really, except for small amounts, want our sterling for direct consumption within England. We want it to help us to purchase goods from England and other countries. And it is here that we come within the power of His Majesty's Government. The latter can, by adopting various measures of exchange control, prevent the conversion of the sterling into other national currencies, e.g., dollar; they can also stop us from buying with it, for export to India, gold or other commodities. Thus, our sterling balances may be blocked. They are blocked balances as they stand even at present.

But that would hardly justify overlooking the essential nature of these balances. These are actually in our possession. Britain will not be called upon to pay them to us over again. The payments have been made. What India wants is to be permitted to use the money that she already has to her best advantage. She wants the blocked balances to be released. A debt has no current purchasing power; our sterling balances have such purchasing power, though, for the present, only within Great Britain.

Official attempts to describe them as debt should, therefore, be discountenanced. If we recognise them to-day as debt, tomorrow we may have to admit them as bad debt. In fact, one member was so much misled by Sir Jeremy Raisman's description of them as debt that he asked whether it was not a good debt after all. Sir Jeremy Raisman was

glad of the opportunity to dilate upon the aspect of the balances as debt, and generously conceded: "It is a perfectly good debt. I agree it is a good debt but I would like to remind the House of the way in which it arises in so far as the financial settlement with His Majesty's Government is meant to be attuned to India's financial capacity. Then, the remainder of the cost of defending India and of measures taken in India becomes part of the sterling balances. It is important to bear that in mind. It is not merely goods that are shipped from India or even services which are sent from India to other theatres of war."

One may retort that it makes no difference whether goods and services provided by India are consumed by their buyers (e.g., His Majesty's Government) within India, or at places outside India where they are exported. In the second place, emphasis is laid upon the fact that our sterling recoveries in London were received in terms of the Financial Settlement of 1939. It is, in fact, difficult to see how that affects the main issue at all. Even admitting, for the sake of argument, that the Financial Settlement has rather favoured us, and that His Majesty's Government would be justified in wanting a revision, would it follow that the payments already made by the latter to us should be placed in a blocked account, or regarded as a permanent debt, or even worse? This is in plain language what Sir Jeremy Raisman purports to say.

The Finance Member, however, failed to impress Sir

Cowasjee Jehangir, who confessed that he was unable to understand why the sterling assets were being described as debt. He believed them to be a certain amount of money in sterling belonging to India in London.

"The debt has been paid," said he, "It is there in sterling with the Reserve Bank; it is no longer a debt; it is money there. The question was if exchange is available between England and America. will there be anything in the way to stop India buying from America, provided the exchange is there, provided the sterling can buy the dollar." To this Sir Jeremy Raisman replied that he had not got time to explain that point. But he repeated his arguments in connection with the point that the sterling balances of India were in fact debt owed by Great Britain to India.

Though our sterling balances should not be designated as debt, and are really ready funds at our disposal in London, we have to recognise, however, some practical limitations on our freedom to use them even after the war. The difficulty of transferring the funds to India during the war in terms of goods and services are obvious enough. But even when the war has ended, it would be hardly possible, or advisable either, to bring them over to ourselves all at once. The very size of the funds would stand in the way. It would be altogether out of the question to write off the funds. against goods and services bought from Great Britain, in the course of a year or even a few years. British industries are now fully occupied with war production and

they will take some time to change over to peace-time occupation. Plants and machinery will have to be largely replaced, for the exhausting conditions under which they are now being employed will reduce many of them to mere scraps of metal. Moreover, the British people who have undergone many privations during the war will naturally claim, with the return of peace, a larger supply of consumption goods—both necessities as well as amenities of life. Thus, it may not be possible to concentrate as fully upon export industries as it would be necessary to do to repay foreign idebtedness in the most expeditious manner.

Very much the same factors will also stand in the way of the ready convertibility of sterling into dollar or other currencies. It is practically a certainty that for some time to come after the war, many of the measures of exchange control which we now find operating will continue to exist. India claims that, after the war, she must be free to exchange her stering for other national currencies in such amounts, or in such manner, as might be decided by herself. In other words, she wants freedom to buy from the best markets of the world. But convertibility of British currency into other currencies would depend directly upon the ability of Britain to build up her export trade. Sterling cannot be converted into dollar unless Great Britain is already in a position to build up a credit balance with the U.S.A., or with some other country to which the U.S.A. is a debtor on current account. Thus, the convertibility of sterling into

multilateral currencies would depend upon the course of international trade after the war, unless, of course, Britain were able to borrow abroad in a systematic manner.

Thus we find that the problem of transfer of our sterling balances from Britain to India after the war hinges upon the multilateral direction of post-war trade. In the main, we shall have to realise our sterling funds only in goods and services. We must. therefore, have necessarily to wait upon the capacity of Great Britain and other countries to send us goods and services in exchange for our sterling or other currencies into which our sterling may be converted. A sudden movement of a huge amount of funds, even if it were possible. would be in all probability deleterious to our own interest. Barter terms of trade would no doubt move against us if we let all our prodigious funds press upon a limited world supply all at once.

It is hardly likely that we would be able, or permitted, to take back our sterling funds in terms of gold. A prime object of the various monetary plans and conferences is to prevent this. Though gold has been officially demonetised in most important countries. it continues to play an indirect part of no mean significance in the determination of monetary policies. A heavy transfer of gold is likely to plunge the country losing the gold into an abyss of depression from which it can lift itself only by bringing about a drastic reduction in its income-and-cost structure. The difficulty, and the virtual unattainability, of such a

course was well illustrated in the case of Great Britain after it returned to an attenuated form of the gold standard in 1925. On the other hand, the country that receives gold is likely to proceed headlong towards a short-lived boom followed by an inevitable depression.

The last decade has, however, taught us amply how to avert the harmful consequences of a sudden influx and efflux of gold, and as the post-war world is even less likely than the world of yesterday to brook monetary effects of gold movements, India has a strong case for being repaid, at least partially, in gold for her sterling balances. We should, however, note in this connection the important fact that the value of gold in the fifth year of the war is very much inflated, largely due to restrictions upon its movement, and if India's sterling balances were to be valued in terms of gold according to its present parity, we shall lose heavily on the transaction.

Of all countries maintaining sterling balances in England, South Africa and Argentina are singular in the fact that both are protected by a gold guarantee to their balances. We have already remarked that South Africa, in fact, holds almost all her sterling in gold, and hence stands no risk of loss consequent upon a depreciation of sterling after the war. Argentina does not hold her sterling in gold, but her sterling balances are protected by a gold guarantee. The guarantee was originally given to her in 1940, and was extended in September 1941 to cover all her spot and forward blocked

sterling balances. While not stipulating for a repayment in gold, the clause, nevertheless, grants her immunity from any hypothetical depreciation of sterling in terms of gold.

Without being unduly dogmatic. we may take for granted a depreciation of sterling after the war in terms of other currencies. Thus, India's sterling balances stand on a somewhat precarious footing. Any inflationary policy pursued by Great Britain after the war will also have the effect of wiping off, in part, our balances. The same will be the effect of currency depreciation by Great Britain with a view to correcting an adverse balance of trade, which we must envisage as an almost inevitable feature of her post-war international trade. It is worth noting in this connection that the Joint Anglo-U.S.A. Monetary Proposals issued in April last permit a debtor country to devalue its currency, on the fulfilment of some easy conditions, by as much as 10 per cent. The original Clearing Union plan drafted by Lord Keynes stipulated that when a member country's debit balance had exceeded a quarter of its quota on the average of at least two years, "it shall be entitled to reduce the value of its currency in terms of bancor provided that the reduction shall not exceed 5 per cent without the consent of the Governing Body."[1] The United States scheme for "A United and Associated Nations Stabilisation Fund,"

1 *Vide Proposals for an International Clearing Union* presented by the Chancellor of the Exchequer to Parliament by Command of His Majesty,—April, 1943. Clause 8(a).

however, set a strong face against devaluation of national currencies by unilateral action and stipulated that while the value of the currency of each member country should be fixed by the Fund in terms of gold or Unitas, it might not be "altered by any member country without the approval of four-fifths of the member votes."[1] Against such a determined attitude taken only a year ago, the consent now given by the U.S.A. to a depreciation of the national currency, almost by unilateral action, by as much as ten per cent, affords a striking example of a complete change of front by a great nation.

While, obviously enough, British authorities themselves look forward to currency depreciation after the war, there is little wonder that various outside countries, having a stake in the stability of the British unit of account, are openly apprehensive of such a contingency. In this connection we may mention, besides India, the names of two other countries, *viz.*, Argentina and the Eire. It would be unfair to read in our solicitude for the post-war stability of sterling any motives unfriendly to Great Britain.

The sterling balances of India are, as we have seen, the result of great suffering undergone by the Indian people. India has suffered the worst inflation of the war to fulfil her role as one of the most important bases of supply for the Allied Governments. It is only natural for her, in such cir-

1 Part IV, Clause 2.

cumstances, to be duly concerned in the safety of her sterling funds, which are the financial counterpart of her sacrifices. It may be mentioned in this connection that certain comments and criticisms appearing recently in the press in Great Britain have lent colour to the misapprehension already existing vaguely in the minds of some persons in India regarding the ultimate fate of our sterling balances.

While all attention is being concentrated on the post-war convertibility of sterling in terms of other currencies, the vitally important aspect of the stability of the external value of sterling itself is being more or less neglected. We may lose much more than we gain if sterling, while made more or less freely convertible into other currencies, emerges out of the war greatly devalued. We have thus a very real stake in the stability of the external value of the British Currency. In the International Monetary Conference, which sat the other day (July, 1944), in Washington, the first concern of the delegates on behalf of India should have been to press for such stability. Alternatively, India may be given a dollar guarantee to her sterling balances on the lines of the gold guarantee to Argentine sterling balances in London.

The fate of our sterling balances in London is also bound up with British monetary policy and the monetary policy of even the Government of India. As already stated, an inflationary policy in Great Britain will have a nugatory effect on our assets in sterling in London. Similarly, if the

rupee-sterling rate of exchange is raised, the same will be the effect on our sterling balances. After the last Great War, the Government of India dissipated, within a few months, the very large amount of sterling acquired by India during the war by raising by a stroke of the pen the external value of the rupee to 2s. gold. Sterling securities and bills bought at the rate of 1s. 4d. to the rupee were sold away at the rate of 2s. gold between February and September. 1920. With a view to maintaining the external value of the rupee at 2s. gold, the Government of India at first sold Reverse Councils at the rate of 2s. 8d. to the rupee. but they subsequently raised the rate to 2s. 10 27/32d. In June, 1920, however, finding that it was impossible to maintain the sterling value of the rupee at so a high rate, the same was brought down to 1s. 11 19/32d. By the end of September, 1920, the Government of India had sold Reverse Councils, at these various ruinous rates, for £55,382,000. Sterling assets of the Paper Currency Reserve in London had to be sold away to make payments on these Reverse Councils. These assets, securities and bills. which had been bought at the rate of Rs. 15 to the pound were now given away at rates varying from Rs. 7 to Rs. 10 per pound. The loss to the Indian exchequer from this sale during these nine months amounted to Rs. 35 crores.

After we have assured ourselves that our sterling balances in London suffer no diminution from adverse monetary policy of Great Britain or of the Government of India, it will

be our next task to ensure their gradual transfer to India. Speaking from the particular view-point of India, the most desirable thing for her would be to have ensured the multilateral convertibility of sterling after the war. But such multilateral convertibility is impracticable unless it is preceded by unhampered multilateral trade, which is, as it must be obvious to everybody, a most unlikely thing to take place for some time after the war. Moreover, our sterling balances are so large that they would seriously disrupt international trade, if we wanted to transfer them to us all at one. Moreover, unplanned imports might prove disruptive to our own indigenous industries. It seems likely, therefore, that we shall have to content ourselves with realising our sterling balances after the war only in a gradual manner.

Anglo-U.S.A. Currency Plans and Sterling Balances.

The disposal of the sterling balances of India form an important subject of discussion in both the British and U.S.A. Currency Plans published in April, 1943. These two separate, and in some respects rival, plans have been since replaced by a Joint Plan, which, however, so far as it appears from a published summary, leaves the subject of the utilisation of the so-called 'abnormal' balance outside the purview of joint deliberations, and refers it presumably to bilateral settlement between the countries concerned. The

treatment of the balances in the separate plans continues, however, to be important, as reflecting the minds of powerful British and U.S.A. political economists on the subject.

"The position of abnormal balances," says the British *Proposals for an International Clearing Union* (drafted by Lord Keynes), "in overseas ownership held in various countries at the end of the war presents a problem of considerable importance and special difficulty. A country in which a large volume of such balances is held could not, unless it is in a creditor position, afford the risk of having to redeem them in bancor on a substantial scale, if this could have the effect of depleting its bancor resources at the outset. At the same time, it is very desirable that the countries owning these balances should be able to regard them as liquid, at any rate over and above the amounts which they can afford to lock up under an agreed programme of funding or long-term expenditure. Perhaps there should be some special over-riding provision for dealing with the transitional period only by which, through the aid of the Clearing Union, such balances would remain liquid and convertible into bancor by the creditor country whilst there would be no corresponding strain on the bancor resources of the debtor country, or, at any rate, the resulting strain would be spread over a period."

As Great Britain would not be in a creditor position after the war, she cannot be asked, according to the argument stated above, to redeem immediately our sterling

balances on a substantial scale. The British plan definitely visualises the locking up of a (substantial) portion of the balances under an agreed programme of funding or long-term expenditure. According to our own arguments, a temporary sterilisation of a part of our sterling funds is practically inevitable; and it would be, then, in our interest to come to a reasonable agreement with Britain on the subject as soon as possible. The British plan makes no attempt, however, to give the outlines of such an agreement.

This is done by the U.S.A. Plan. While the British plan treats the subject of abnormal balances in more or less general terms, the U.S.A. Plan deals with it in great detail and lays down an elaborate scheme of disposing of such balances in twenty-three years' time. According to the U.S.A. Plan, the Stabilisation Fund would have the power to buy from the Governments of member countries, abnormal balances held in other countries, provided various conditions, including the following, are met:

"(a) The country selling the abnormal balances to the fund agrees to transfer these balances to the Fund and to repurchase from the fund 40 per cent of them;

"(b) The abnormal balances are in member countries and are reported as such (for the purpose of this provision) by the member Government on the date of its becoming a member.

"(c) The country selling the abnormal balances to the Fund agrees to transfer these balances to the Fund and to re-

purchase from the fund 40 per cent of them (at the same price) with gold or such currencies as the Fund may wish to accept, at the rate of 2 per cent of the transferred balances each year for 20 years beginning not later than 3 years after the date of transfer.

"(d) A charge of 1 per cent, payable in gold, shall be levied against the country selling its abnormal balances and against the country in which the balances are held. In addition, a charge of 1 per cent, payable in gold, shall be levied annually against them on the amount of such balances remaining to be repurchased in each country.

"(d) If the country selling abnormal war balances to the fund asks for foreign exchange rather than local currency, the request will not be granted unless the country needs the foreign exchange for the purpose of meeting an adverse balance of payments not arising from acquisition of gold, the accumulation of foreign balances, or other capital transactions."

The U.S.A. Plan, in its application to the case of India, means in effect that we shall forego 20 per cent of our sterling balances, shall take 40 per cent of them in the shape of imports from Great Britain over a period not exceeding 23 years, and shall obtain the remaining 40 per cent in the shape of imports from the rest of the world over the same period.

While the point with respect to the taking of imports from Great Britain to the extent of 40 per cent of our ster-

ling balances may be more or less conceded, there is no reason why (1) we shall forfeit 20 per cent of the funds, which are the result of so much sacrifice; nor (2) why we should not have reasonable freedom to take imports against the residue of the balances from countries of our own choice, and also (3) why even a partial realisation of the funds in terms of gold shall be altogether ruled out.

Repurchase by India of 40 per cent of the sterling balances sold by her previously is tantamount to purchase by her of imports from Great Britain to that extent, and as no obligation is imposed upon her to repurchase the rest of the balances she is to be presumably free to purchase imports against the remaining portion of the sterling balances (40 per cent, after making allowance for 20 per cent writing off) from the rest of the world. But in this connection one should bear in mind the fact that under the American Scheme a member country will be permitted to buy from another country only when there is an adequate supply of the currency of the latter country. When the Fund's holdings of the currency of any country run short, it will apportion the available supply among different countries making a demand for that currency according to their respective urgencies. The provisions regarding the rationing of a scarce currency are important and they run as follows:

"Whenever it becomes evident to the Board of Directors that the anticipated demand for any particular currency

may soon exhaust the Fund's holdings of that currency, the Board of Directors of the Fund shall inform the member countries of the probable supply of this currency and of a proposed method for its equitable distribution, together with suggestions for helping to equate the anticipated demand and supply for that currency.

"The Fund shall make every effort to increase the supply of the scarce currency by acquiring that currency from the foreign balances of member countries. The Fund may make special arrangements with any member country for providing an emergency supply under appropriate conditions which are acceptable to the Fund and the member country.

"The privilege of any country to acquire an amount of other currencies equal to or in excess of its quota shall be limited by the necessity of assuring an appropriate distribution among the various members of any currency the supply of which is being exhausted. The Fund shall apportion its sales of such scarce currency. In such apportionment, it shall be guided by the principle of satisfying the most urgent needs from the point of view of the general economic situation. It shall also consider the special needs and resources of the particular countries making the request for the scarce currency."

The joint Anglo-U.S. Monetary Proposals (signed also by other members of the United and Associated Nations) also contain provisions for the rationing of a scarce currency.

These provisions are however less elaborate, but are substantially the same. For comparison and contrast, they are reproduced below:

"(1) When it becomes evident to the Fund that the demand for a member country's currency may soon exhaust the Fund's holdings of that currency, the Fund shall so inform member countries and propose an equitable method of apportioning the scarce currency. When a currency is thus declared scarce, the Fund shall issue a report embodying causes of the scarcity and containing recommendations designed to bring it to an end.

"(2) A decision by the Fund to apportion a scarce currency shall operate as an authorisation to a member country, after consultation with the Fund, temporarily to restrict the freedom of exchange operations in the affected currency, and in determining the manner of restricting the demand and rationing the limited supply among its nationals the member country shall have complete jurisdiction."

All this reinforces the view already expressed above that while India will be called upon to purchase 40 per cent of the imports from Great Britain, she will have little freedom to choose her markets regarding the remaining 40 per cent. Her freedom to purchase from America will be in all probability the most restricted of all, in view of the prospective demand for dollars from all sides. A united demand should go forth from this country to let us have as much dollar as would be possible in exchange for our

sterling balances in London. In this connection, the decision of the Government of India to build up a Dollar Fund to aid post-war reconstruction of India is to be highly welcomed. The Fund would be built up, as was explained by the Finance Member in his budget speech for 1944-45, by setting aside "each year from now a part of the dollars accruing from India's exports to the U.S.A., apart from and in addition to our current dollar requirements which are met from the Empire Dollar Pool."

Some Proposals by the Government of India for Utilising a part of the Sterling Balances:—While it hardly lies with the Government of India, by unilateral action, to determine in all its aspects the question of the utilisation of our sterling balances, any attempt by them to solve the problem, even partially, should be welcome. In his budget speech for 1943-44, Sir Jeremy Raisman made a number of suggestions for utilising a portion of our surplus sterling. One minor proposal was to pay off our Chatfield debt amounting to £34 millions. Another proposal referred to the constitution of a Post-war Reconstruction Fund for financing post-war reconstruction, including rehabilitation and reequipment of industry.

A more serious proposal was, however, that for the capitalisation of the sterling pensions, family pensions and provident funds. It was estimated that during the period that lay ahead, the charges under these heads would amount to £5 to £6 millions a year. The Government

proposed that they might make advance provision for the requisite sterling remittance for making payments in respect to these liabilities, on the lines of the arrangements already made by them with regard to the sterling railway annuities. "This," said Sir Jeremy Raisman, "in effect involves the purchase from His Majesty's Government, by the investment of a capital sum at a suitable rate of interest, of the right to receive a series of sterling payments estimated to be sufficient to meet the relevant charges over the period during which they are likely to have to be met. These charges, and consequently the sterling remittance required to meet them, would naturally after a certain time gradually decline in amount until they disappeared, and the transaction might thus be described as the purchase of a tapering annuity." The Finance Member further explained that "it was not contemplated that the rights of any class of Government servants would be affected, or that the liability to the pensioners should be transferred from the Government of India. The arrangement would be purely financial, and would amount to the investment of a capital sum in return for which the Government of India would at stated intervals receive stated sums of sterling with which they would be in a position, as far as can be estimated, to meet these sterling obligations."

The Finance Member further advocated that this sort of investment would naturally provide a much more favourable rate of interest than that earned on the present invest-

ments in sterling treasury bills. In this connection, one might say that it is not enough that the rate of interest earned is better than the treasury bill rate; it has to be good enough as compared with other long-term rates for similar investments. As we have already seen, we have failed to secure a good enough rate on the investment made by us with His Majesty's Government for advance provision for sterling remittance with respect to our liabilities in connection with the railway annuities.

When there can be no question of India ever ceasing to admit her obligations in connection with the sterling pensions, family pensions and provident funds, an advance provision for the due discharge of these obligations, provided this does not interfere with still more urgent uses of our sterling resources, is quite desirable, and if by making such advance provision we can earn a remunerative rate of interest on a part of our surplus (and for the time being unusable) sterling, that would be an additional recommendation for the taking of such a step. The capital sum needed for the purpose of making such an advance provision is estimated to be £150 millions, and this is, in fact, in the words of Sir Jeremy Raisman, "the equivalent of a large scale repatriation."

According to many Indians, one most profitable use of our surplus sterling would be to buy off British investments in India. We lack, however, any accurate statistics of the total value of the British investments in this country

and hence the extent to which they may be helpful to us in repatriating our sterling assets is somewhat problematical.

According to one recent estimate made by "an unnamed but most reputable City authority" in London, Britain's direct investments in India now total £240,000,000, divided among (a) companies operating in India but registered outside India (£100,000,000), (b) British-owned companies registered in India (£75,000,000), (c) other trade interests (£50,000,000) and (d) Indian Municipal and harbour loans (15,000,000).[1]

Assuming that this is a fairly correct estimate of the British investments in India and that they can be made use of for clearing Britain's indebtedness to us, it is obvious that they can help us to repatriate our sterling assets to the extent of only one-fourth, while with regard to the remaining three-fourths, the same problems as now baffle us would persist.

We must not, however, underrate the importance of even a quarter solution of our problems arising out of our surplus sterling. But there are real objections, from the purely Indian point of view, to the immediate use of the British investments in India as a set-off against our sterling balances. For, if we are to buy off the tangible and intangible assets of the British businesses in India here and now against our surplus sterling in London, we must pay for

1 Vide *The Amrita Bazar Patrika,* Report from London Office, dated 13th November, 1943.

them a price commensurate with their current values as distinguished from their face values or book values. Current values are patently hyper-inflated on account of abnormal war profits which now accrue to such businesses and they are bound to sag heavily with the return of normal conditions in the post-war period. If we are to buy off the British investments in India just at the present moment, we shall be indeed operating in a very dear market. All this is said apart from the violent political objections that are sure to be raised from the British quarters to any scheme thrusting upon them any further disinvestment in India.

Recent British Suggestions for Scaling down the Sterling Assets of India.—A section of the British press, headed by such influential organs of British financial opinion as the *Financial News* and *The Economist*, as well as some important political economists of Great Britain as Lord Keynes have been in the recent months carrying on a vigorous campaign to impress upon us the idea that our sterling assets have been received by us in very extraordinary ways, and that Britain has, therefore, almost a natural right to divest us of a large part of these assets.

Proceeding from the high-sounding dictum that "since Britain and India are fighting for a common cause, neither country should expect to increase its national wealth at the other's expense," the *Financial News* of Great Britain opines that while "part of its sterling balances might be made available to India to effect purchases within Britain

and the sterling bloc, a larger part should be earmarked as special non-interest-bearing reserve for use only in an emergency."[1] Thus, according to this paper (a) while we may not as a matter of right get back any part of our sterling balances, a small part, which must be however less than 50 per cent, may be made available to us at the discretion of Great Britain; (b) secondly, in the event of such a small part of our sterling balances being made available to us, we must be restricted to the use of that part for purchases only from Great Britain and other countries in the sterling block; and, as a necessary consequence, we must be altogether debarred from making purchases with that sterling from America and other countries outside the sterling area; (c) thirdly, the bulk of our sterling balances may never be released to us and (d) lastly, our sterling balances in London must not carry any interest.

Says *The Economist*:—"The case for revision does not merely rest on complete change of conditions caused by Japan's entry into the war, that formed the basis of the original settlement, but also rests on the fact that the Allies' purchases in India have been made at inflated prices, which, owing to control of the exchange market, have not been able to reflect themselves in the exchange rate of the rupee."

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1 Quoted by *Commerce*, for July 1, 1944. The subsequent excerpts from *The Financial News* and *The Economist* are also taken from the same source.

"The accumulation of sterling assets by India," continues *The Economist*, "has, therefore, been considerably stimulated by rise in rupee prices. Assuming the price stabilisation policy in Great Britain to be successfully maintained after the war, that sterling will represent the purchasing power over considerably greater volume of goods than that which went to building it up. If only on this comparison of real terms of trade in the two countries, there would seem to be strong grounds not merely for re-negotiation of a settlement but some retrospective reconsideration of the debt (*sic*) to which it has given rise."

To this argument it may be replied that, in India, not only has the external value of the rupee been controlled, but also the prices of goods purchased by the Government. When the public at large had no option but to make their purchases of even the commonest necessities of life from the black market, the Government of India supplied to the Allied Government numerous war materials at officially controlled rates, which were in no other cases really operative. Therefore, our sterling accumulations with respect to such purchases were rather depressed by the fact that these purchases were made at less than the ruling (black market) prices. If the Government of India controlled *neither* the external value of the rupee *nor* the internal prices, they would have to pay a much higher total price for the war purchases in India, and even if the relatively higher price-level of India, following the classical purchas-

ing power parity theory, reflected itself in a lower rate of exchange, the net effect on our sterling accumulations because of the higher rupee price of the war purchases, might not have been appreciably different. Thirdly, in the very short period in which the purchases were made, it is hardly likely that, in the absence of exchange control, the external value of the rupee would have adjusted itself to the internal price-level. Such adjustment, as is well-known, always takes time to accomplish itself.

Moreover, even admitting a weakening of the rupee internally, the war purchases in India of the Allied Governments, which involved a demand for the rupee, would rather tend to neutralise such weakness.

Let us, in conclusion, point out a family likness, to which a reference has been made by the *Commerce* of Bombay, between the treatment proposed to our sterling balances by *The Economist* of Great Britain and that proposed in a speech delivered on March 13, 1944, by Herr Walter Funk, President of the Reich Bank, and Reich Minister of National Economy, to the credits accumulated against Germany by various continental countries during the war. On behalf of his Government Herr Frunk guaranteed "the liquidation of the clearing balances after the war of marketable manufactures at rates of exchange corresponding to the purchasing power parities prevailing at the time when the balances were accumulated." It should be remembered in this connection that the rise of internal prices

during this war has been much greater, proportionately speaking, in German occupied countries than within Germany itself.

The following criticism of Dr. Funk's proposal, then made by the *Financial News,* would also apply to the argument of *The Economist,* with no more alteration being necessary than the substitution of the word England for the word Germany.

"The exchange rates calculated on the basis of the purchasing power parities would thus be considerably less favourable to Germany's creditors and considerably more favourable to Germany. If the post-war deliveries in settlement of the clearing claims were based on these revised exchange rates, it would mean that the creditor countries would receive considerably less than the nominal amount of their claims. Thus, the ingenious formula would involve, in practice, the repudiation of a large part of these claims."

To end this chapter on a happier note, let us mention, however, that at the last International Monetary Conference held in the U.S.A., Lord Keynes was persuaded by the Indian Delegation to make a categorical statement that "under no circumstances will there be any repudiation of their debts by the British Government" who would respect their obligations "scrupulously and honourably."[1] It is

1 Vide *The Amrita Bazar Patrika,* dated August 25, 1944.

now understood, reports an Associated Press message dated the 23rd August, 1944, that His Majesty's Government will, in the near future, invite representatives of the Government of India to the United Kingdom for an exploratory talk for the settlement of India's sterling balances in Britain. If Britain adheres to her decision to discharge her obligations "scrupulously and honourably," the path of a settlement is already well-laid.

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